

Castle Brands Inc
Form 10-Q
February 14, 2008

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 December 31, 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)

(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 February 13, 2008.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

CASTLE BRANDS INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

December 31,

2007 March 31,

2007 (Unaudited)	ASSETS	CURRENT ASSETS	Cash and cash equivalents	\$ 791,063
\$ 1,004,957	Short-term investments	7,171,374	5,912,464	Accounts receivable – net of allowance for doubtful accounts of \$221,934 and \$352,458
8,159,861	8,159,861	6,503,449	11,407	10,328
10,156,765	10,716,983	Prepaid expenses and other current assets	1,531,829	1,585,901
CURRENT ASSETS	27,822,299	25,734,082	EQUIPMENT – net	734,543
			643,753	OTHER ASSETS
			Intangible assets – net of accumulated amortization of \$2,464,676 and \$2,233,808	13,769,977
			13,813,596	
Goodwill	12,495,287	13,036,650	Restricted cash	745,620
			502,643	Other assets
			560,697	795,237
TOTAL ASSETS	\$ 56,128,423	\$ 54,525,961	LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES			Current maturities of notes payable and capital leases	\$ 3,824
Accounts payable	3,644,858	5,150,535	Accrued expenses, put warrant payable and derivative instrument	
1,809,495	1,987,669	Due to stockholders and affiliates	934,170	1,092,755
LIABILITIES	6,392,347	8,650,267	LONG TERM LIABILITIES	Senior notes payable
				9,575,547
			9,354,861	Notes payable and capital leases, less current maturities
			9,002,321	9,005,207
liability	2,444,254	2,555,368	TOTAL LIABILITIES	27,414,469
CONTINGENCIES (Note 15)			29,565,703	COMMITMENTS AND
EQUITY			MINORITY INTERESTS	302,378
			1,407,645	STOCKHOLDERS'
			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 December 31, and March 31, 2007, respectively	156,298
			121,098	Additional paid in capital
			84,086,710	Accumulated deficiency
			(74,505,799)	(59,962,237)
			Accumulated other comprehensive loss	(1,719,445)
			(692,958)	TOTAL STOCKHOLDERS' EQUITY
			28,411,576	23,552,613
			TOTAL	LIABILITIES AND STOCKHOLDERS' EQUITY
			\$ 56,128,423	\$ 54,525,961

See accompanying notes to the condensed consolidated financial statements.

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

	Three-months Ended			Nine-months Ended					
December 31,	2007	2006	2007	2006	2007	2006			
December 31,	2007	2006	2007	2006	Sales, net	\$ 6,401,749	\$ 7,380,605	\$ 20,946,786	\$
19,093,072	Cost of sales	4,616,017	4,938,243	14,557,276	12,733,747	Allowance for obsolete and slow-moving inventory	1,707,035	—	1,707,035
6,359,325	Selling expense (Note 1L)	5,011,180	4,599,783	13,685,410	12,836,429	Gross profit	78,697	2,442,362	4,682,475
	administrative expense (Note 1L)	2,072,462	2,101,331	6,224,491	6,235,824	General and amortization	236,150	262,926	791,851
(16,019,277)	Net operating loss	(7,241,095)	(4,521,678)	(16,019,277)	(13,456,142)	Other income	—	1,096	—
(40,719)	Other expense	(19,255)	(21,132)	(40,719)	(36,998)	Foreign exchange gain	144,454	483,799	1,304,389
	Write-off of deferred financing costs in connection with conversion of 6% subordinated convertible notes	—	—	(295,368)	—	Current credit on derivative financial instrument	—	132,255	189,397
111,109	Income tax benefit	37,038	37,033	111,109	Minority interests	613,877	366,208	1,105,267	1,101,422
(3,730,512)	Net loss	\$ (6,857,900)	\$ (3,730,512)	(3,730,512)	\$ (14,543,562)	Preferred stock dividends	—	—	—
	Net loss attributable to common stockholders	\$ (6,857,900)	\$ (3,730,512)	\$ (14,543,562)	\$ (12,060,890)	Net loss attributable to common stockholders per common share, basic and diluted	\$ (0.44)	\$ (0.31)	\$ (0.96)
\$ (1.02)	Weighted average shares used in computation, basic and diluted	15,629,776	12,051,045	15,141,981	11,827,837				

See accompanying notes to the condensed consolidated financial statements.

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	
(14,543,562)	(14,543,562)	(14,543,562)	Foreign currency translation adjustment				
(1,026,487)	(1,026,487)	Total comprehensive loss			(15,570,049)	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	807,268	807,268	BALANCE, DECEMBER 31, 2007	15,629,776	\$		
156,298	\$ 104,480,522	\$ (74,505,799)	\$ (1,719,445)	\$ 28,411,576			

See accompanying notes to the condensed consolidated financial statements.

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

Nine-months Ended December 31,		2007	2006	CASH FLOWS FROM OPERATING ACTIVITIES		Net
loss	\$ (14,543,562)	\$ (12,012,652)		Adjustments to reconcile net loss to net cash used in operating activities:		
	Depreciation and amortization	791,851	743,214	Change in provision for doubtful accounts	186,752	
	66,201	Minority interest in net loss of consolidated subsidiary	(1,105,267)	(1,101,422)	Loss on disposal of fixed assets	1,068
	—	Write-off of deferred financing costs	484,369	390,756	Current (credit) on derivative financial instrument	(189,397)
	(189,397)	(121,397)	Deferred tax benefit	(111,114)	(111,109)	Effect of changes in foreign currency rate
	(1,304,813)	(997,604)	Stock-based compensation expense	807,268	1,057,396	Increase in allowance for obsolete inventories
	1,681,293	—	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	(1,586,986)	(4,938,326)) Increase in due from affiliates		
	—	(92,715)	Increase in inventory	(883,438)	(2,607,467)	Decrease/(increase) in prepaid expenses and supplies
	62,239	(198,592)	Increase in other assets	(25,882)	(139,590)	Decrease in accounts payable, accrued expenses, put warrant payable and derivative instrument
	(1,769,774)	(58,528)	(Decrease)/increase in due to related parties	(219,366)	175,720	Total adjustments
	(3,181,197)	(7,354,368)	NET CASH USED IN OPERATING ACTIVITIES		(17,724,759)	(19,367,020)
CASH FLOWS FROM INVESTING ACTIVITIES		Acquisition of property and equipment		(236,614)	(221,631)	
	Acquisition of intangible assets	(20,219)	(129,144)	Business acquisitions – net of cash acquired	—	(1,282,021)
	Purchase of short-term investments	(10,000,000)	—	Proceeds from sale of short-term investments	8,741,090	—
	NET CASH USED IN INVESTING ACTIVITIES		(1,515,743)	(1,632,796)	CASH FLOWS FROM FINANCING ACTIVITIES	
	Repayment of notes payable		(16,173,044)	(18,538,838)		
	Proceeds from notes payable and warrants	15,739,778	20,677,017	Payments of obligations under capital leases		
	(2,745)	(2,609)	Increase in restricted cash	(179,800)	(97,985)	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
	19,002,675	30,639,522	EFFECTS OF FOREIGN CURRENCY TRANSLATION			
	23,933	43	NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS			
	(213,894)	9,639,749	CASH AND CASH EQUIVALENTS – BEGINNING			
	1,392,016	CASH AND CASH EQUIVALENTS – ENDING	\$ 791,063	\$ 11,031,765	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	Issuance of common stock			
	\$ —	\$ 705,200	Interest paid			
	\$ 1,307,163	\$ 1,000,963	Income taxes paid			
	\$ —	\$ —				

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 (“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, 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 had 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 & Kyne, Castle Brands Inc.’s wholly-owned foreign subsidiaries, CB-IRL and CB-UK, and Castle Brands, Inc.’s majority owned subsidiary, 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.

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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 the bourbon products, which are bottled in the United States, all of the Company’s products are imported from Europe. The vodka, Irish whiskeys and certain liqueurs are produced by CB-IRL, billed in euros and imported into the United States. The risk of fluctuations in foreign currency 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 money market accounts and mutual funds that are highly liquid in nature and represent the investment of cash that is available for current operations. The mutual fund portfolio is composed of corporate debt, commercial paper, repurchase agreements, mortgage backed securities, commercial mortgage backed securities, bank obligations, asset backed commercial paper, and asset backed securities and had a net asset value of \$1.00 per unit at December 31, 2007.

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, are comprised of distilled spirits, raw materials (bulk spirits, bottles, labels and caps), packaging and finished goods, and are 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.

In December 2007 the Company recorded an allowance for obsolete and slow moving inventory of \$1,707,035. This allowance was recorded on both raw materials and finished goods, primarily in the disposition of old packaging of Boru vodka, rendered obsolete with the repackaging in March 2007, and the old packaging of Clontarf Irish whiskey, rendered obsolete with the upcoming launch of the new Clontarf packaging in March 2008. The Company has reserved taking an allowance against the old Boru packaging in previous quarters as it was attempting to sell-off the old inventory in select markets. As of December 31, 2007 the new Boru packaging is available across all major markets and the Company does not foresee the ability to sell-off the old packaging in significant quantities. The allowance against the old Clontarf packaging has been recorded in the current quarter as production of the old packaging ended as of December 31, 2007 and the Company has

minimal finished product remaining. In addition, in an effort to refocus efforts on faster growing and more profitable SKUs and bottle sizes, the Company is reducing the number of both on some of its other products, primarily Gosling's rums. The charge has been recorded as an increase to Cost of Sales in the current period.

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 December 31, and March 31, 2007, goodwill and other indefinite lived intangible assets that arose from acquisitions were \$12.5 million and \$13.0 million, respectively. The change in the value of goodwill and other indefinite lived intangible assets is due to the completion of a third party valuation of intangible assets acquired in the McLain & Kyne acquisition versus initial estimated values. 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 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.

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 in excise taxes and VAT. These taxes are reflected in both the Company's revenues and cost of sales as an equal increase to both. During the three-months and nine-months ended December 31, 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

	December 31, 2007		Nine-months ended 2006	
Sales, net	\$ 869,035	\$ 1,809,820	\$ 5,197,091	\$ 4,431,836
Cost of Sales	\$ 869,035	\$ 1,809,820	\$ 5,197,091	\$ 4,431,836

K. Foreign

currency – The functional currency for the Company's foreign operations is the euro in Europe, excluding the United Kingdom, where it is the British pound. 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, vodka, Irish whiskeys 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 of the international subsidiaries. At each balance sheet date, the euro denominated intercompany balances included on the books of CB-IRL are restated in U.S. dollars at the exchange rate in effect at the balance sheet date, with the resulting foreign currency transaction gain or loss included in net income.

L. Stock-based

compensation – Incremental compensation expense for the three-months ended December 31, 2007 and 2006 amounted to \$270,952 and \$285,981, respectively, of which

\$115,417

and \$136,604 are included in selling expense, respectively, and \$155,535 and \$149,377 are in general and administrative expense, respectively, in the accompanying condensed consolidated statements of operations. Incremental compensation expense for the nine-months ended December 31, 2007 and 2006 amounted to \$807,268 and \$1,057,396, respectively, of which \$344,996 and \$358,076 are included in selling expense, respectively, and \$462,203 and \$699,320 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 registration rights penalty 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 December 31, 2007 and 2006, the Company recorded a 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 nine-months ended December 31, 2007 and 2006, respectively. Effective with the Company's registration statement (Reg. no. 333-143422), as amended, filed with the SEC on June 29, 2007 and effective as of July 9, 2007, the registration rights penalty was reversed.

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 December 31, 2007 and 2006 was \$949,500 and \$946,124, respectively, and \$2,721,523 and \$3,475,024 for the nine-months ended December 31, 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, stock-based compensation, 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 GAAP, 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 2009 fiscal year. In December 2007, the FASB released a proposed FASB Staff Position (FSP FAS 157b – Effective Date of FASB Statement No. 157) which, if adopted as proposed, would delay the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). 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 SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities,” 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.

On December 4, 2007, the FASB issued SFAS No. 141(R), “Business Combinations,” and SFAS No. 160, “Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51.” SFAS No. 141(R) is required to be adopted concurrently with SFAS No. 160 and is effective for business combination transactions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early adoption is prohibited. Application of SFAS No. 141(R) and SFAS No. 160 is required to be adopted prospectively, except for certain provisions of SFAS No. 160, which are required to be adopted retrospectively. Business combination transactions accounted for before adoption of SFAS No. 141(R) should be accounted for in accordance with SFAS No. 141 and that accounting previously completed under SFAS No. 141 should not be modified as of or after the date of adoption of SFAS No. 141(R). The Company is currently evaluating the impact of SFAS No. 141(R) and SFAS No. 160, but does not expect the adoption of these pronouncements to have a material impact on the Company’s financial position or results of operations.

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 nine-months ended December 31, 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:

						December 31,
2007	December 31,					
2006	Stock options	1,557,625	1,428,500	Stock warrants	2,305,432	812,218
	Convertible debentures					
1,192,380	1,125,000	Total	5,055,437	3,365,718		

NOTE 3 — INVESTMENTS

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

			Estimated			
Fair Value	December 31, 2007	Money Market Accounts	\$ 2,022,410	Mutual fund	5,148,964	Total \$
7,171,374						

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

NOTE 4 — INVENTORIES

						December 31,
2007	March 31,					
2007	Raw materials	\$ 2,357,276	\$ 1,501,455	Finished goods	7,799,489	9,215,528
						Total
						\$ 10,156,765
		\$ 10,716,983				

As of December 31, and March 31, 2007, 78.6% and 99.1%, respectively, of the raw materials and 5.1% 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, and are shown net of an allowance for obsolete and slow moving inventory of \$1,707,035 and \$261,000 at December 31, and March 31, 2007, respectively.

NOTE 5 — INTANGIBLE ASSETS

Intangible assets consist of the following:

						December 31,
2007	March 31,					
2007	Definite life brands	\$ 300,944	\$ 308,909	Trademarks	478,073	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	11,570,290	11,755,404
						Less: accumulated amortization
2,464,676	2,233,808	Net	9,105,614	9,521,596		
						Other identifiable intangible assets – indefinite life trade
						names and formulations
		4,664,363	4,292,000	\$ 13,769,977	\$ 13,813,596	

Accumulated amortization consists of the following:

						December 31,
2007	March 31,					
2007	Definite life brands	\$ 243,329	\$ 230,992	Trademarks	58,176	25,790
						Rights
						1,634,054
1,220,093	Patents	230,217	183,333	Distribution relationship	—	329,600
						Supply relationships
		244,000	Accumulated amortization	\$ 2,464,676	\$ 2,233,808	

Amortization expense for the three-months ended December 31, 2007 and 2006 totaled \$188,046 and \$219,463, respectively, and \$646,868 and \$621,465 for the nine-months ended December 31, 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 with the termination date.

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

					For the years ending December 31,	Amount 2008
\$ 784,211	2009	784,211	2010	784,211	2011	784,211
					2012	784,211
					Total	\$ 3,921,055

NOTE 6 — RESTRICTED CASH

The Company has cash collateral on deposit for creditors insurance in Ireland of €506,243, or \$745,620 (as translated at the exchange rate in effect on December 31, 2007).

NOTE 7 — OVERDRAFT ACCOUNTS

CB-IRL and CB-UK maintain overdraft coverage with a financial institution in Ireland of up to €400,000 (\$589,140) and £20,000 (\$39,975), respectively. Overdraft balances included in notes payable totaled \$0 and \$380,334 at December 31, and March 31, 2007, respectively.

NOTE 8 — SENIOR NOTES PAYABLE, NOTES PAYABLE AND CAPITAL LEASES

						December 31,
2007	March 31,					
2007	Notes payable consist of the following:			Revolving credit facilities	\$ —	\$ 407,261
facilities	—	8,363	Senior notes payable	9,575,547	9,354,861	Subordinated convertible notes
						9,000,000
		9,000,000	18,575,547	18,770,485	Capital leases	6,145
					8,891	Total
						\$ 18,581,692
						\$ 18,779,376

Principal payments due over the next five years for the above listed notes payable and capital leases are as follows (as translated at the exchange rate in effect on December 31, 2007):

						For the years ending December 31,	2008	\$ 3,824
2009	9,577,868	2010	9,000,000	Total	18,581,692	Less current portion	3,824	Non current portion
								\$ 18,577,868

NOTE 9 — COMMON STOCK

Unregistered Sales of Equity Securities – On April 18, 2007, the Company entered into a Securities Purchase Agreement (the “Securities Purchase Agreement”) with selected investors (each an “Investor” and collectively, the “Investors”). Pursuant to the terms of the Securities Purchase Agreement, the Company has sold in a private placement a total of 3,520,035 shares of its common stock, (the “Common Stock”), for aggregate gross proceeds of \$21,014,609. Net proceeds to the Company after offering costs were \$19,618,484. The transaction closed on May 8, 2007. The Investors included, among others, Frederick M. R. Smith and Phillip Frost, MD, each a director of the Company, and CNF Investments II, LLC, of which Robert J. Flanagan, a director of the Company, is a manager.

As part of the transaction, investors received warrants to purchase approximately 1,408,014 additional shares at an exercise price of \$6.57 per share (the “Warrants”). The Warrants will remain exercisable for a period of five years from the closing of the offering. The Warrants contain anti-dilution protection for stock splits and similar events, but do not contain any price-based anti-dilution adjustments. In connection with the transaction, Piper Jaffray & Co., as placement agent was issued a warrant to purchase 35,200 shares of Common Stock at an exercise price of \$5.97 per share, exercisable within five years following the issuance of the warrant (the “Agent Warrant”). The Agent Warrant is otherwise on the same terms and conditions as the Warrants.

Registration Rights Agreement – On April 18, 2007, the Company entered into a Registration Rights Agreement (the “Registration Rights Agreement”) with the Investors. Pursuant to the Registration Rights Agreement, the Company has agreed to register the resale of the shares of Common Stock sold to the Investors pursuant to the Securities Purchase Agreement, including the shares issuable upon exercise of the Warrants. The Company agreed to file with the SEC a registration statement with respect to this registration within 30 days after closing. The Company filed such registration statement on May 31, 2007, within this 30 day timeframe. The registration statement was declared effective as of July 9, 2007.

NOTE 10 — FOREIGN CURRENCY FORWARD CONTRACTS

The Company enters into forward contracts to attempt to limit 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 December 31, 2007, the Company held outstanding forward exchange positions for the purchase of euros, expiring through February 2008, in the amount of \$590,720 with a weighted average conversion rate of €1 = \$1.4768 as compared to the spot rate at December 31, 2007 of €1 = \$1.4728. Gain or loss on foreign transactions related to the foreign currency forward contracts, which was de minimis, is included in other income and expense.

NOTE 11 — PROVISION FOR INCOME TAXES

On January 1, 2007, the Company adopted the provisions of FIN 48 – “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109”. FIN 48 clarifies and sets forth consistent rules for accounting for uncertain tax positions in accordance with FAS 109, “Accounting for Income Taxes.”

As a result of the implementation of FIN 48, the Company made a review of its portfolio of uncertain tax positions in accordance with recognition standards established by FIN 48. In this regard, an uncertain tax position represents the Company’s expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return, that has not been reflected in measuring income tax expense for financial reporting purposes. As a result of this review, the Company determined that it had no material uncertain tax positions and, therefore, it has not recorded unrecognized tax benefits. The Company does not expect any material changes to its uncertain tax positions.

The tax years 2005 through 2007 remain open to examination by federal and state tax jurisdictions.

The Company has various foreign subsidiaries for which tax years 2001 through 2007 remain open to examination in certain foreign tax jurisdictions.

The Company’s income tax benefit for the three-months and nine months ended December 31, 2007 and 2006 consists of federal and 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 deferred tax liability is

being reversed and a deferred tax benefit is being recognized over the amortization period of the intangible asset (15 years). For the three-months ended December 31, 2007 and 2006, the Company recognized \$37,038 and \$37,033 of deferred tax benefits, respectively, and \$111,114 and \$111,109 for the nine-months ended December 31, 2007 and 2006, respectively.

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On December 1, 2003, the Company recorded a deferred tax liability of \$629,444 as the amount ascribed to the difference between the book and tax basis of the tangible and intangible assets acquired as additional goodwill.

Pursuant to FIN 48, the Company recognizes interest and penalties related to uncertain tax positions in the provision for income taxes. The Company did not recognize any such interest and/or penalties during the nine-months ended December 31, 2007 and 2006.

NOTE 12 — STOCK OPTIONS AND WARRANTS

A. Stock

Options – In July 2003, the Company implemented the 2003 Stock Incentive Plan (the “Plan”) which provides for awards of incentive and non-qualified stock options, restricted stock and stock appreciation rights for its officers, employees, consultants and directors in order to attract and retain such individuals who contribute to the Company’s success by their ability, ingenuity and industry knowledge, and to enable such individuals to participate in the long-term success and growth of the Company by giving them an equity interest in the Company. There are 2,000,000 common shares reserved and available for distribution under the Plan, of which 442,375 remain available. Stock options granted under the Plan are granted with an exercise price at or above the fair market value of the underlying common stock at the date of grant, generally vest over a four or five year period and expire ten years after the grant date.

At December 31, 2007, total unrecognized compensation cost amounted to approximately \$2,069,333, representing 858,925 of unvested options. There were no options exercised under the share-based payment arrangements during the nine-months ended December 31, 2007 and 2006.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model and is affected by assumptions regarding a number of highly complex and subjective variables. The use of an option pricing model also requires the use of a number of complex assumptions, including expected volatility, risk-free interest rate, expected dividends, and expected term. Expected volatility is based on the historical volatility of a peer group of companies over the expected life of the option as the Company does not have enough history trading as a public company to calculate its own stock price volatility. The expected term and vesting of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option. The Company has not paid dividends in the past and does not plan to pay any dividends in the near future. SFAS 123R also requires the Company to estimate forfeitures at the time of grant and revise these estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company estimates forfeitures based on its expectation of future experience while considering its historical experience.

A summary of the options outstanding under the Plan is as follows:

Nine-months ended December 31,		2007	2006	Shares	Weighted			
Average								
Exercise								
Price	Shares	Weighted						
Average								
Exercise								
Price	Outstanding at beginning of period	1,294,125	\$ 7.19	888,500	\$ 6.82	Granted	298,500	
3.71	540,000	8.18	Forfeited (35,000)	6.51	—	—	Outstanding at end of period	1,557,625
6.54	1,428,500	7.09	Options exercisable at period end	698,700	\$ 7.10	416,467	\$ 6.65	
Weighted average fair value of options granted during the period				\$ 1.27	\$ 3.67			

The following table represents information relating to stock options outstanding at December 31, 2007:

Options Outstanding	Options Exercisable	Range of Exercise Prices		Shares	Weighted						
Average											
Remaining											
Life in											
Years	Shares	Weighted									
Average											
Exercise											
Price	Aggregate										
Intrinsic											
value	\$3.00 – \$4.00	250,000	9.87	—	3.09	\$ —	\$5.01 – \$6.00	440,500	6.27	312,700	6.00
—	\$6.01 – \$7.00	129,500	9.24	36,375	6.93	—	\$7.01 – \$8.00	537,000	7.71	254,000	7.76
	\$8.01 – \$9.00	200,625	8.53	95,625	9.00	—	1,557,625	7.52	698,700	7.10	\$ —

The fair value of options at date of grant was estimated using the Black-Scholes option-pricing model utilizing the following weighted average assumptions:

	2007	December 31,		December 31,
Risk-free interest rates	4.92 %	4.44 – 5.19%	Expected options life in years	6.75 7.00
Expected stock price volatility	50 %	75%	Expected dividend yield	0 % 0%

The following summarizes the activity of the Company's stock options that have not vested for the three-months and nine-months ended December 31, 2007:

						Shares		Weighted	
Average									
Exercise									
Price Nonvested at April 1, 2007	720,500	\$ 7.21	Granted	48,500	6.93	Canceled or expired	(35,000)		
6.51 Vested (64,225)	7.25	Nonvested at June 30, 2007	669,775	\$ 7.29	Granted	—	—	Canceled or	
expired — —	Vested (41,725)	6.72	Nonvested at September 30, 2007	628,050	\$ 7.31	Granted			
250,000	3.09	Canceled or expired	—	—	Vested (19,125)	7.01	Nonvested at December 31, 2007		
858,925	\$ 6.09								

As of December 31, 2007, there was \$2,069,333 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under existing stock option plans. This cost is expected to be recognized over a weighted-average period of 3.15 years. The total fair value of shares vested during the three-months ended December 31, 2007 and 2006 was \$270,952 and \$24,720, respectively, and \$807,268 and \$462,701, for the nine-months ended December 31, 2007 and 2006, respectively.

Since no options were exercised, the Company did not recognize any related tax benefit for the nine-months ended December 31, 2007 and 2006.

B. Stock Warrants – The Company has entered into various warrant agreements.

Common Stock Warrant Issued to the Financing Agent

On August 29, 2002, in connection with a revolving credit facility, the Company granted to the lender, Keltic Financial Partners, LP (“Keltic”), a warrant to acquire 100,000 shares of the Company’s common stock at an exercise price of \$6.00. The warrant is subject to anti-dilution provisions upon the occurrence of certain events such as stock splits and stock dividends, vests immediately and is exercisable through September 1, 2014. The warrant is exercisable at any time and includes a cashless exercise provision. The Company was not obligated to register the warrant or the underlying shares, except to the extent that, if the Company elected to file a registration statement, Keltic could have the shares underlying its warrant included in that registration statement and the Company would assume all registration costs and other expenses in connection with such registration.

On September 27, 2005, the warrant was amended to eliminate the cash put feature and replace it with certain penalties (up to \$200,000) if the shares underlying the warrant were not registered by June 1, 2007 and June 1, 2008. The Company agreed that if on either June 1, 2007 or June 1, 2008 (a) there were shares of common stock received or issuable upon the exercise of the warrant that have not been registered, and (b) it had not filed a registration statement with respect to which Keltic had the opportunity to register the unregistered shares, the Company would pay Keltic \$100,000 within ten (10) days of such dates. The Company filed such registration statement on May 31, 2007 and Keltic elected to have the shares underlying its warrant included in such registration statement.

Effective with the Company’s registration statement (Reg. no. 333-143422), as amended, filed with the SEC on June 29, 2007 and effective as of July 9, 2007, the registration rights penalty was eliminated. The Company has reflected the fair value of the combined instrument at March 31, 2007 included in the balance sheet caption accrued expenses, put warrants payable and derivative instrument of approximately \$189,397.

Common Stock Warrants Issued to Senior Note Holders

In connection with the issuance of the latest tranche of senior notes in November 2006, the Company entered into a warrant agreement to grant the right to purchase 213,600 shares of the Company's common stock at an exercise price of \$8.00 per share at any time through May 31, 2009. These warrants were recorded at relative fair value and accounted for as a discount to the face value of the senior notes and a credit to additional paid-in capital in the amount of \$706,944. This discount will be recognized over the adjusted term of the senior notes with a charge to interest expense and a credit to senior notes payable. For the three-months ended December 31, 2007 and 2006, the Company recorded \$73,562 and \$43,807 respectively of senior note accretion as interest expense, and \$220,686 and \$54,093 for the nine-months ended December 31, 2007 and 2006, respectively.

Common Stock Warrants Issued to Financial Advisor

In July 2005, the Company granted to a financial advisor warrants to purchase up to 100,000 shares of common stock at \$8.00 per share. The warrants are subject to anti-dilution provisions, such as stock splits and stock dividends, and vested upon the completion of the initial public offering in April 2006. The Company ascribed a fair value to the warrant of \$283,727 and recorded a charge upon vesting. The charge is included in interest expense for the nine-months ended December 31, 2006 on the accompanying condensed consolidated statements of operations.

Common Stock Warrant Issued to Lender of Credit Facility

Upon entering into the credit agreement described in Note 15 I, the Company issued to the Lender a warrant to purchase 50,000 shares of Common Stock, par value \$0.01 per share, at an exercise price of \$4.00 per share at any time through March 31, 2012. The warrants are subject to anti-dilution provisions, such as stock splits and stock dividends, and vested upon issuance. The Company ascribed a fair value to the warrant of \$79,711 and will account for the warrant as a deferred financing cost to be amortized over the life of the underlying credit facility.

The following is a summary of the Company's outstanding warrants for the nine-months ended December 31, 2007:

				Warrants		Weighted	
Average							
Exercise							
Price Per							
Warrant	812,218	\$ 7.75	Granted	1,443,214	6.57		
Exercised	—	—	Forfeited	—	—	Warrants outstanding and exercisable, June 30, 2007	2,255,432 \$ 6.99
Granted	—	—	Exercised	—	—	Forfeited	—
2,255,432	\$ 6.99	Granted	50,000	4.00	Exercised	—	—
		Exercisable, December 31, 2007	2,305,432	\$ 6.93	Forfeited	—	—

NOTE 14 — RELATED PARTY TRANSACTIONS

A. The Company is operating under an agreement with MHW, Ltd. ("MHW") whereby MHW acts as the Company's agent in the distribution of its products across the United States.

MHW's president also serves as a director of the Company and has a de minimis indirect ownership interest in the Company. In addition, MHW has a 10% ownership interest in the Celtic Crossing trade mark, one of the Company's products, in the United States and its territories, Canada, Mexico, and the Caribbean.

Pursuant to the MHW distribution agreement, MHW receives sales orders from the Company's domestic wholesalers at prices agreed upon with the Company. MHW simultaneously purchases Company inventory necessary to fill those orders and ships that inventory to the various wholesalers. MHW then invoices, collects, and deposits remittances from those wholesalers into an MHW bank account designated for the Company. The funds are remitted to the Company on a bi-weekly basis. Although MHW is responsible for the billing function, the collected funds are the property of the Company and MHW is not liable to the Company for any unpaid balances due from wholesalers.

In addition to the distribution services provided for the Company, MHW also provides administrative and support services on behalf of the Company. For the three-months ended December 31, 2007 and 2006, aggregate charges recorded for all services provided were approximately \$70,376 and \$71,033, respectively and were \$239,789 and \$195,391 for the nine-months ended December 31, 2007 and 2006, respectively. These charges have been included in general and administrative expenses on the accompanying condensed consolidated statements of operations.

B. The Company has transactions with Knappogue Corp., a stockholder in the Company. Knappogue Corp. is controlled by the Company's Chairman and his family. The transactions primarily involve rental fees for use of Knappogue Corp.'s interest in the Knappogue Castle for various corporate purposes, including Company meetings and to entertain the Company's customers. For the three months ended December 31, 2007 and 2006, the Company recognized rental fees of \$4,845 and \$10,000 respectively, and recognized \$68,086 and \$15,000 for the nine-months ended December 31, 2007 and 2006, respectively. These charges have been included in selling expense in the accompanying condensed consolidated statement of operations.

C. In April 2004, the Company contracted with BPW, Ltd. ("BPW"), for business development services including providing introductions for the Company to agency brands that would enhance the Company's portfolio of products and assisting the Company in successfully negotiating agency agreements with targeted brands. BPW is controlled by a director of the Company. For the three-months ended December 31, 2007 and 2006, the Company recognized fees of \$14,661 and \$10,772, respectively and \$47,145 and \$33,318 for the nine-months ended December 31, 2007 and 2006, respectively, under this contract. These charges have been included in general and administrative expense in the accompanying condensed consolidated statement of operations.

D. For the three-months ended December 31, 2007 and 2006, and for the nine-months ended December 31, 2007 and 2006, the Company purchased goods from Terra Manufacturing Limited ("Terra") and Carbery Milk Products Limited ("Carbery") of approximately \$654,678 and \$932,325, respectively, and \$2,361,032 and \$1,824,851, respectively. The Company had assumed the underlying supplier agreements with Terra and Carbery from CB-IRL. Terra's affiliate, Tanis Investments, and Carbery are both shareholders in the Company. As of December 31 and March 31, 2007, the Company was indebted to these two affiliates in the amount of approximately \$576,377 and \$893,221, respectively, which is included in due to stockholders and affiliates on the accompanying condensed consolidated balance sheet.

E. For the three-months ended December 31, 2007 and 2006, the Company made royalty payments of approximately \$10,864 and \$10,396, respectively, and for the nine-months ended December 31, 2007 and 2006 the Company made payments of \$31,282 and \$29,912, respectively, for use of a patent, to an entity that is owned by two stockholders in the

Company. These charges have been included in other expense on the accompanying condensed consolidated statements of operations. The royalty agreement also includes the right to acquire the patent for the Trinity Bottle for €90,000 (\$132,557) for the duration of the licensing period, which expires on December 1, 2008.

NOTE 15 — 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 2017, subject to annual extensions on a rolling ten year basis. 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 year and contracts to purchase that amount. For the calendar year ended December 31, 2007, the Company had contracted to purchase approximately €566,349 in bulk Irish whiskey. The Company is not liable to 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 has entered into a distribution agreement with Gaelic Heritage Corporation, Ltd. (“Gaelic”), an international supplier, to be the sole-producer of Celtic Crossing, one of the Company’s products, for an indefinite period.

C. In August 2004, Castle Brands entered into an agency agreement with I.L.A.R. S.p.A. (“ILAR”), the producer of Pallini Limoncello and its flavor extensions, to be the sole and exclusive importer of Pallini Limoncello and its flavor extensions throughout the United States and its territories and possessions. This agreement is subject to automatic renewal for three or five years per renewal period depending upon Castle Brands achievement of contractual case sale targets. The agreement expires on December 31, 2009, unless the contractual case sales targets have been met.

Under this agreement, Castle Brands is permitted to import Pallini Limoncello and its flavor extensions at a set price, updated annually, and is obligated to set aside a portion of the gross margin toward a marketing fund for Pallini Limoncello and its flavor extensions. The agreement also encompasses the hiring of a Pallini Brand Manager at Castle Brands with ILAR reimbursing the costs of this position up to a stipulated annual amount. These reimbursements are included in the accompanying condensed consolidated financial statements as a reduction in selling expense.

D. In September 2004, CB-USA entered into an exclusive distribution agreement with Gosling’s Export (Bermuda) Limited (“GXB”) to be the sole and exclusive importer of Gosling’s rum brands within the United States. Under this agreement, CB-USA receives a net sales commission on each case sold. In February 2005, GXB sold its interest in the distribution agreement to GCP.

CB-USA receives a stipulated commission per case, subject to adjustment, provided certain case sales are achieved, for all sales in calendar years under the distribution agreement. The sales commission is net of agreed reimbursements, including taxes and payments to the marketing affiliate, GCP. This distribution agreement is for fifteen years, subject to extension.

The Gosling’s global distribution agreement, which excludes Bermuda, commenced on April 1, 2005 and has a 15 year term. It is renewable for additional 15 year terms as long as GCP meets certain case sale targets during the initial term as set forth in the agreement. The Company ascribed the entire purchase of \$5,000,000 to the Gosling global distribution agreement described above. In conjunction with this transaction the Company recorded a deferred tax liability of \$2,222,222 to reflect the difference between the adjusted book value and tax basis. This deferred tax liability was recorded as an increase to the value of the distribution agreement and is included in intangible assets.

The Company has agreed to fund certain operating losses of GCP. The balance funded at December 31, 2007 is approximately \$3,950,000. This balance is partially evidenced by a GRID note and guaranteed proportionately by the minority shareholders of GCP.

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E. The Company subleases office space in Dublin, Ireland and New York, NY and leases office space in Houston, TX and Louisville, KY. The Dublin office lease commenced on June 1, 2004 and extends through February 28, 2009. Rent is payable quarterly in advance. The New York, NY lease commenced on August 15, 2004 and extends through March 30, 2008. The Houston lease commenced on February 24, 2000 and extends through March 31, 2009. The Louisville lease commenced June 1, 2004, became effective for the Company concurrent with the acquisition of McLain & Kyne, Ltd., and extends through May 31, 2009. The Company has also entered into non-cancelable operating leases for certain office equipment.

Future minimum lease payments are as follows:

					For the years ending December 31, Amount 2008
\$ 73,734	2009	22,962	2010	4,349	Total \$ 101,045

In addition to the above annual rental payments, the Company is obligated to pay its pro-rata share of utility and maintenance expenses on the leased premises. Rent expense under operating leases amounted to approximately \$108,520 and \$107,776 for the three-months ended December 31, 2007 and 2006, respectively, and \$322,931 and \$305,759 for the nine-months ended December 31, 2007 and 2006, respectively, and is included in general and administrative expense on the accompanying condensed consolidated statements of operations.

F. Pursuant to the distribution agreement signed in March 1998 between the Company and Gaelic, which was amended and restated in April 2001, the Company, which currently owns 60% of the Celtic Crossing trademark in the United States, has the option to purchase 70% of the trademark outside the United States from Gaelic at a specified price adjusted by interim, annual changes in the Irish Consumer Price Index.

In the event of the sale of the brand rights by either the Company or Gaelic, the non-selling party shall have the right of first refusal to purchase the interest at the same price as the proposed sale and the right to sell alongside the other party.

Pursuant to the agreement, the Company is required to pay royalties to Gaelic for each case purchased. Such royalties are included within cost of sales in the accompanying consolidated statements of operations.

G. Pursuant to a composite inter-company guarantee in the amount of €860,000 (\$1,266,608) completed in February 2005 between the Company, CB-IRL and CB-UK, the Company has guaranteed the loans from Ulster Bank to the Company's European subsidiaries.

H. The Company is subject to strict government regulations associated with the marketing, importation, warehousing, transportation and distribution of spirits.

I. On October 22, 2007, the Company entered into a credit agreement with Frost Nevada Investments Trust, which is controlled by Dr. Phillip Frost, a former director of the Company, which enables the Company to borrow up to \$5,000,000. Any amounts outstanding under the Credit Facility bear interest at a rate of 10% per annum. Interest is payable quarterly. The maturity date of any amounts outstanding is the earlier of (i) one business day after the closing of financing transactions which results in aggregate gross proceeds to the Company of at least \$10,000,000 and (ii) February 28, 2009.

Upon entering into the credit agreement, the Company paid the lender a facility fee of \$175,000. If the Company draws down any amount under the Credit Facility, upon the Company receiving its first advance, the Company would have to pay the Lender an additional facility fee of \$200,000. As additional consideration for entering into the Credit Facility, the Company issued to the Lender a warrant to purchase 50,000 shares of Common Stock, par value \$0.01 per share, at an exercise price of \$4.00 per share (Note 12 B).

NOTE 16 — CONCENTRATIONS

A. Credit

Risk – The Company maintains its cash and short-term investment balances at various large financial institutions that, at times, may exceed federally and internationally insured limits. As of December 31, 2007, the Company exceeded the insured limit by approximately \$7,228,220. Management believes the Company is not exposed to any significant credit risk because the institutions are international money center banking institutions with strong financial positions.

B.

Suppliers – The Company has entered into a supplier agreement with Irish Distillers, which provides for the production of single malt, blended and grain Irish whiskeys for the Company through 2017, with automatic renewal thereafter for successive five (5) calendar year renewal terms.

The Company has entered into a distribution agreement with Gaelic, an international supplier, to be the sole-producer of Celtic Crossing, one of the Company's products, for an indefinite period.

The Company has entered into a distribution agreement with ILAR to be the sole-producer of the Pallini premium Italian liqueurs, expiring December 31, 2009, subject to a three or five year renewal, depending on case purchase.

The Company has entered into a distribution agreement with GXB, an international supplier, to be the sole-producer of the Gosling's family of rum products for 15 years.

The Company has entered into a supplier agreement with Carbery, an international supplier, which provides for the production of the Company's vodka and cream products through December 31, 2008.

The Company has entered into a bottling and services agreement with Terra which provides for the bottling of the Company's vodka, whiskey and cream products through February 28, 2009.

C.

Customers – Sales to the Company's three largest customers for the three-months and nine-months ended December 31, 2007 accounted for approximately 32% and 31%, respectively, of the Company's revenues and approximately 27% of accounts receivable at December 31, 2007.

NOTE 17 — LEGAL PROCEEDINGS

The Company's subsidiary, Castle Brands Spirits Company Limited, is the holder of a trademark registration for the mark "BORU" with the United States Patent and Trademark Office. On May 9, 2007, Distillerie Stock U.S.A. Ltd. filed a Petition for Cancellation with the United States Patent and Trademark Office for the cancellation of the trademark registration for BORU on several grounds, including potential confusion between BORU and its existing registered trademark "BORA". The Company has filed a response presenting various defenses on the merits as well as procedural defenses in a timely manner against Distillerie Stock's claims. The Company intends to vigorously pursue these defenses as appropriate. Currently, the matter is pending at the United States Patent and Trademark Office before the Trademark Trial and Appeal Board. While matters before the Trademark Trial and Appeal Board cannot result in monetary damages or directly affect the right to use a trademark, they can result in the cancellation of a trademark registration. Thus, it is possible this matter could result in the cancellation of the Company's trademark registration for BORU in the United States. As a result, it is not feasible to predict the final outcome, and there can be no assurance that these claims might not be finally resolved adversely to the Company, resulting in material liability to its operations.

On September 6, 2007 the Company was served with a lawsuit, International Brands USA, Inc. v. Castle Brands, Inc., now pending in Supreme Court, New York County, New York. The complaint alleges several claims relating to the Company's decision not to proceed with the acquisition of a privately-held spirits importing business. The Company believes the claims have no legal or factual merit and is vigorously defending the matter.

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NOTE 18 — GEOGRAPHIC INFORMATION

The Company operates in one business – premium branded spirits. The Company’s product categories are vodka, rum, liqueurs/cordials, and whiskey and 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 percentage of consolidated revenue and consolidated assets from the U.S. and foreign countries.

For the three-months ended December 31,		2007	2006	Consolidated Revenue:		International			
\$ 1,880,092	29.4 %	\$ 3,058,076	41.4 %	United States	4,521,657	70.6 %	4,322,529	58.6 %	
Total Consolidated Revenue		\$ 6,401,749	100 %	\$ 7,380,605	100 %	Consolidated Depreciation and Amortization:			
		International	\$ 23,312	9.9 %	\$ 20,235	7.7 %	United States	212,838	
90.1 %	242,691	92.3 %	Total Consolidated Depreciation and Amortization		\$ 236,150	100 %	\$		
262,926	100 %	Income Tax Benefit:		United States	\$ 37,038	100 %	\$ 37,033	100 %	
% Revenues by Category:		Vodka	\$ 1,410,477	22.0 %	\$ 2,945,816	39.9 %	Rum		
1,620,016	25.3 %	1,669,504	22.6 %	Liqueurs/Cordials	1,541,200	24.1 %	1,413,295	19.2 %	
Whiskey	1,757,580	27.5 %	1,301,652	17.6 %	Other*	72,476	1.1 %	50,338	0.7 %
Total Consolidated Revenue		\$ 6,401,749	100 %	\$ 7,380,605	100 %	Consolidated Assets:			
International	\$ 7,339,200	13.1 %	\$ 6,900,484	11.5 %	United States	48,867,260	86.9 %		
53,295,905	88.5 %	Total Consolidated Assets		\$ 56,206,460	100.0 %	\$ 60,196,389	100.0 %		

For the nine-months ended December 31,				2007	2006 Consolidated Revenue:		International		
\$ 7,072,714	33.8 %	\$ 6,910,260	36.2 %	United States	13,874,072	66.2 %	12,182,812	63.8 %	
Total Consolidated Revenue		\$ 20,946,786	100 %	\$ 19,093,072	100 %	Consolidated Depreciation and Amortization:			
		International	\$ 67,296	8.5 %	\$ 58,530	7.9 %	United States	724,555	
91.5 %	684,684	92.1 %	Total Consolidated Depreciation and Amortization		\$ 791,851	100 %	\$		
743,214	100 %	Income Tax Benefit:		United States	\$ 111,114	100 %	\$ 111,109		
100 % Revenues by Category:				Vodka	6,979,373	33.3 %	\$ 6,807,968	35.7 %	
5,614,047	26.8 %	5,614,389	29.4 %	Liqueurs/Cordials	4,530,850	21.6 %	3,793,007	19.9 %	
Whiskey	3,529,912	16.9 %	2,722,324	14.3 %	Other*	292,604	1.4 %	155,384	0.7 %
Total Consolidated Revenue		\$ 20,946,786	100 %	\$ 19,093,072	100 %				

* Includes

related food products.

NOTE 19 — SUBSEQUENT EVENTS

On February 4, 2008, the Company entered into an Agreement (the “Agreement”) with Autentica Tequilera S.A. de C.V. (“Autentica Tequilera”), pursuant to which the Company became the exclusive US importer of a new super premium tequila, “Tequila Tierras Autenticas de Jalisco” (“Tierras”).

Pursuant to the Agreement, the Company obtained rights of first refusal with respect to the importation of (i) any new market for Tierras (except Mexico), and a (ii) any new products of Autentica Tequilera within the US or any other market (except Mexico). The Company also obtained a right of first refusal on any sale of the Tierras brand, and a right to acquire up to 35% of the economic benefit of any such sale with a third-party based upon the achievement of certain cumulative sales targets. The Agreement has a term of five years, with automatic five-year renewals based upon sale targets, which are agreed for the first two renewals and to be negotiated for subsequent renewals.

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

Cautionary Note Regarding Forward Looking Statements

This Quarterly Report on Form 10-Q includes statements of our expectations, intentions, plans and beliefs that constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are intended to come within the safe harbor protection provided by those sections. These statements, which involve risks and uncertainties, relate to the discussion of our business strategies and our expectations concerning future operations, margins, profitability, liquidity and capital resources and to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. We have used words such as “may,” “will,” “should,” “intends,” “plans,” “anticipates,” “believes,” “thinks,” “seeks,” “expects,” “predicts,” “could,” “projects,” “potential” and other similar terms and phrases, including references to assumptions, in this report to identify forward-looking statements. These forward-looking statements are made based on expectations and beliefs concerning future events affecting us and are subject to uncertainties, risks and factors relating to our operations and business environments, all of which are difficult to predict and many of which are beyond our control, that could cause our actual results to differ materially from those matters expressed or implied by these forward-looking statements. These risks and other factors include those listed under “Risk Factors” in our Annual Report on Form 10-K for the year ended March 31, 2007 and elsewhere in this report. The following factors, among others, could cause our actual results and performance to differ materially from the results and performance projected in, or implied by, the forward-looking statements:

- our history of losses and expectation of further losses;
- the effect of poor operating results on our company;
- the effect of growth on our infrastructure, resources and existing sales;
- our ability to expand our operations in both new and existing markets and our ability to develop or acquire new brands;
- the impact of supply shortages and alcohol and packaging costs in general;
- our ability to raise capital;
- negative publicity surrounding our products or the consumption of beverage alcohol products in general;
- our ability to acquire and/or maintain brand recognition and acceptance;
- trends in consumer tastes;
- our ability to protect trademarks and other proprietary information;
- the impact of litigation;
- the effect of the impact of federal, state, local or foreign government regulations;
- the effect of competition in our industry; and
- economic and political conditions generally.

We assume no obligation to publicly update or revise these forward-looking statements for any reason, or to update the reasons actual results could differ materially from those anticipated in, or implied by, these forward-looking statements, even if new information becomes available in the future.

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The following information should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2007, as well as in conjunction with the condensed consolidated financial statements and related notes appearing elsewhere in this Form 10-Q.

Overview

We develop and market premium branded spirits in several growing market categories, including vodka, rum, whiskey and liqueurs, and we distribute these spirits in all 50 U.S. states and the District of Columbia, in select international markets, including Ireland, Great Britain, Northern Ireland, Germany, Canada, South Africa, Russia and the Duty Free markets, and in a number of other countries in continental Europe. The brands we market include, among others, Boru vodka, Gosling’s rum, Clontarf Irish Whiskey, Knappogue Castle Whiskey, Jefferson’s, Jefferson’s Reserve and Sam Houston bourbons, Celtic Crossing and the Pallini liqueurs. Beginning in calendar 2008, we expect to begin marketing and distributing a line of super-premium tequilas.

Our current growth strategy focuses on: (a) aggressive brand development to encourage case sales and revenue growth of our existing portfolio of brands through significant investment in sales and marketing activities, including advertising, promotion and direct sales personnel expense; and (b) the selective addition of complementary premium brands through a combination of strategic initiatives, including acquisitions, joint ventures and long-term exclusive distribution arrangements.

In December 2007 we recorded an allowance for obsolete and slow moving inventory of \$1.7 million. We recorded this allowance on both raw materials and finished goods, primarily in the disposition of our old packaging of Boru vodka, rendered obsolete with our repackaging in March 2007, and our old packaging of Clontarf Irish whiskey, rendered obsolete with our upcoming launch of the new Clontarf packaging in March 2008. We have not taken an allowance against the old Boru packaging in previous quarters as we were attempting to sell-off the old inventory in select markets. As of December 31, 2007 we have rolled out the new Boru packaging across all major markets and do not foresee the ability to sell-off the old packaging in significant quantities. We have taken an allowance against the old Clontarf packaging in the current quarter as we have stopped producing in the old packaging as of December 31, 2007 and have minimal finished product remaining. In addition, in an effort to refocus our efforts on our faster growing and more profitable SKUs and bottle sizes, we are reducing the number of both on some of our other products, primarily Gosling’s rums. This \$1.7 million charge has been recorded as an increase to Cost of Sales in the current period and has a significant negative effect on our reported gross profit and gross margin.

Operational performance overview

The following table sets forth certain information regarding our case sales for the three-months and nine-months ended December 31, 2007 and 2006. The data in the following table is based on nine-liter equivalent cases, which is a standard spirits industry metric.

Three-months Ended

December 31, Nine-months Ended

December 31, Case Sales		2007	2006	Cases		United States		46,427	48,593		
151,920	139,230	International	23,107	43,089	90,122	103,065	Total	69,534	91,682		
242,042	242,295	Vodka	26,702	51,298	117,831	124,335	Rum	17,491	16,691	59,412	
59,676	Liqueurs/cordials	14,768	15,987	42,264	41,099	Whiskey	10,573	7,706	22,535		
17,185	Total	69,534	91,682	242,042	242,295	Percentage of Cases	United States				
66.8 %	53.0 %	62.8 %	57.5 %	International	33.2 %	47.0 %	37.2 %	42.5 %	Total	100.0	
%	100.0 %	100.0 %	100.0 %	Vodka	38.4 %	56.0 %	48.7 %	51.3 %	Rum	25.2 %	18.2
%	24.5 %	24.6 %	Liqueurs/cordials	21.2 %	17.4 %	17.5 %	17.0 %	Whiskey	15.2 %	8.4	
%	9.3 %	7.1 %	Total	100.0 %	100.0 %	100.0 %	100.0 %				

Sales in the United States, which accounted for over two-thirds of our sales in the current fiscal quarter, represent our sales to wholesalers. Depletions are shipments from wholesale distributors to retail customers, and are commonly regarded in the industry as an approximate measure of consumer demand. Wholesalers typically order products from us based on their current inventory and anticipated depletions, and may periodically seek to adjust their carried inventory. As our products have gained acceptance in the marketplace, our wholesale distributors have increasingly been placing orders for ‘‘direct imports’’, which are full container orders shipped directly to the wholesaler, instead of first being held by us or our agents at a bonded warehouse. While increases in direct imports are typically viewed as an increasing sign of health for our brands, they may periodically result in periodic swings in orders for our products. We have engaged an outside company, Dimensional Insights, to track and provide us with depletion data (measuring the sales from our distributors to their retail customers) in order to monitor depletion data, which generally demonstrates consumer purchases of our products, which is measured in smaller increments than distributor orders and therefore a more consistent reporting metric.

Results of operations

The following table sets forth, for the periods indicated, the percentage of net sales of certain items in our financial statements.

Three-months Ended				Nine-months Ended					
December 31,	2007	2006	2007	2006	December 31,	2007	2006	2007	2006
Sales, net	100.0 %	100.0 %	100.0 %	100.0 %	Cost of sales	98.8 %	66.9 %	77.6 %	66.7 %
Gross profit	1.2 %	33.1 %	22.4 %	33.3 %	Selling expense	78.3 %	62.3 %	65.3 %	67.2 %
General and administrative expense	32.4 %	28.5 %	29.7 %	32.7 %	Depreciation and amortization	3.7 %	3.6 %	3.8 %	