# 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, 2006**

**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 00-32849**

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

| | |
|---|---|
| **Delaware**<br>(State or other jurisdiction of incorporation or organization) | **41-2103550**<br>(I.R.S. Employer Identification No.) |
| **570 Lexington Avenue, New York, New York**<br>(Address of principal executive offices) | **10022**<br>(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).

☐ 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 12,009,741 shares of $0.01 par value common stock outstanding at November 8, 2006.

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## PART I. FINANCIAL INFORMATION

### Item 1. Consolidated Financial Statements

**CASTLE BRANDS INC. AND SUBSIDIARIES**
**Condensed Consolidated Balance Sheets**

| | September 30, 2006 (unaudited) | March 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 13,509,471 | $ 1,392,016 |
| Accounts receivable – net of allowance for doubtful accounts of $463,351 and $395,207 | 6,454,173 | 3,511,215 |
| Due from affiliates | 1,032,287 | 953,616 |
| Inventories | 8,777,275 | 6,673,235 |
| Prepaid expenses and other current assets | 1,308,656 | 1,021,369 |
| **TOTAL CURRENT ASSETS** | 31,081,862 | 13,551,451 |
| **EQUIPMENT**— net | 470,193 | 407,983 |
| **OTHER ASSETS** | | |
| Intangible assets – net of accumulated amortization of $1,788,096 and $1,379,389 | 13,631,672 | 13,936,427 |
| Goodwill | 11,649,430 | 11,649,430 |
| Deferred registration costs | — | 2,823,594 |
| Restricted cash | 475,814 | 362,293 |
| Other assets | 548,741 | 913,032 |
| **TOTAL ASSETS** | $ 57,857,712 | $ 43,644,210 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)** | | |
| **CURRENT LIABILITIES** | | |
| Current maturities of notes payable and capital leases | $ 1,563,941 | $ 3,678,547 |
| Accounts payable | 3,325,502 | 3,757,515 |
| Accrued expenses, put warrant payable and derivative instrument | 2,466,191 | 2,986,188 |
| Due to stockholders and affiliates | 2,058,941 | 2,121,334 |
| Convertible stockholder notes payable | — | 1,660,148 |
| Stockholder notes payable | — | 147,113 |
| **TOTAL CURRENT LIABILITIES** | 9,414,575 | 14,350,845 |
| **LONG TERM LIABILITIES** | | |
| Senior notes payable | 4,605,088 | 4,594,791 |
| Notes payable and capital leases, less current maturities | 9,007,380 | 15,350,640 |
| Preferred stock and preferred membership units dividends payable | — | 1,546,480 |
| Deferred tax liability | 2,629,439 | 2,703,515 |
| | 25,656,482 | 38,546,271 |
| **REDEEMABLE CONVERTIBLE PREFERRED STOCK** | | |
| Redeemable convertible preferred stock Series A, B, C; 4,103,750 shares designated; 4,089,463 shares outstanding at March 31, 2006, liquidation preference of $33,326,484 | — | 28,447,683 |
| **COMMITMENTS AND CONTINGENCIES (Note 15)** | | |
| **MINORITY INTERESTS** | 1,939,517 | 2,674,731 |
| **STOCKHOLDERS' EQUITY (DEFICIENCY)** | | |
| Common stock, $.01 par value, 20,500,000 shares authorized, 12,009,741 and 3,106,666 shares issued and outstanding at September 30, 2006 and March 31, 2006, respectively | 120,098 | 31,067 |
| Additional paid in capital | 82,049,026 | 17,182,405 |

| | | |
|---|---|---|
| Accumulated deficiency | (51,687,027) | (43,404,887) |
| Accumulated other comprehensive (loss)/income. | (220,384) | 166,940 |
| **TOTAL STOCKHOLDERS' EQUITY (DEFICIENCY)** | 30,261,713 | (26,024,475) |
| **TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)** | $ 57,857,712 | $ 43,644,210 |

See accompanying notes to the condensed consolidated financial statements.



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

| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 (See Note 20) |
| Sales, net | $ 6,252,062 | $ 5,175,144 | $ 11,712,467 | $ 10,091,538 |
| Cost of sales | 4,231,445 | 3,162,084 | 7,795,504 | 6,315,276 |
| Gross profit | 2,020,617 | 2,013,060 | 3,916,963 | 3,776,262 |
| Selling expense (Note 1R) | 4,694,074 | 3,212,398 | 8,236,646 | 6,349,785 |
| General and administrative expense (Note 1R) | 1,898,702 | 1,235,794 | 4,134,493 | 2,373,270 |
| Depreciation and amortization | 245,794 | 220,343 | 480,288 | 441,828 |
| Operating loss | (4,817,953) | (2,655,475) | (8,934,464) | (5,388,621) |
| Other income | 2,644 | 34,132 | 3,944 | 34,132 |
| Other expense | (9,558) | (9,154) | (15,866) | (18,609) |
| Foreign exchange gain/(loss) | 262,377 | 15,247 | 659,789 | (297,724) |
| Interest expense, net | (75,931) | (365,274) | (498,607) | (624,204) |
| 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) | (1,752) | (10,858) | 15,050 |
| Income tax benefit | 37,038 | 37,038 | 74,076 | 74,076 |
| Minority interests | 391,855 | 94,898 | 735,214 | 224,057 |
| Net loss | (4,218,194) | (2,850,340) | (8,282,140) | (5,981,843) |
| Preferred stock dividends | — | 386,583 | 48,238 | 691,762 |
| Net loss attributable to common stockholders | $ (4,218,194) | $ (3,236,923) | $ (8,330,378) | $ (6,673,605) |
| Net loss attributable to common stockholders per common share | | | | |
| Basic | $ (0.35) | $ (1.04) | $ (0.71) | $ (2.15) |
| Diluted | $ (0.35) | $ (1.04) | $ (0.71) | $ (2.15) |
| Weighted average shares used in computation | | | | |
| Basic | 12,009,741 | 3,106,666 | 11,716,233 | 3,106,666 |
| Diluted | 12,009,741 | 3,106,666 | 11,716,233 | 3,106,666 |

See accompanying notes to the condensed consolidated financial statements.



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

| | Common Stock | | Additional | | Accumulated | Total |
|---|---|---|---|---|---|---|
| | Shares | Amount | Paid in Capital | Accumulated Deficiency | Other Comprehensive Income/(Loss) | Stockholders' Equity/ (Deficiency) |
| **BALANCE, MARCH 31, 2006** | 3,106,666 | $ 31,067 | $17,182,405 | $(43,404,887) | $ 166,940 | $(26,024,475) |
| Comprehensive loss | | | | | | |
| Net loss | | | | (8,282,140) | | (8,282,140) |
| Foreign currency translation adjustment | | | | | (387,324) | (387,324) |
| Total comprehensive loss | | | | | | (8,669,464) |
| Accrued preferred stock dividends | | | (48,238) | | | (48,238) |
| Issuance of common stock in initial public offering, net of issuance costs | 3,500,000 | 35,000 | 26,393,889 | | | 26,428,889 |
| Conversion of redeemable convertible preferred stock, net of fractional shares | 4,089,463 | 40,895 | 28,406,772 | | | 28,447,667 |
| Issuance of common stock in payment of accrued dividends | 193,107 | 1,931 | 1,387,834 | | | 1,389,765 |
| Conversion of 5% euro denominated convertible subordinated notes | 263,362 | 2,634 | 1,660,539 | | | 1,663,173 |
| Conversion of 40% of 6% convertible subordinated notes | 857,143 | 8,571 | 5,991,429 | | | 6,000,000 |
| Vesting of stock options as compensation | | | 19,254 | | | 19,254 |
| Estimated fair value ascribed to warrants issued to financial consultant | | | 283,727 | | | 283,727 |
| Stock-based compensation | | | 771,415 | | | 771,415 |
| **BALANCE, SEPTEMBER 30, 2006** | 12,009,741 | $120,098 | $82,049,026 | $(51,687,027) | $(220,384) | $ 30,261,713 |

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, | |
|---|---|---|
| | 2006 | 2005 (See Note 20) |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| **Net loss** | $ (8,282,140) | $ (5,981,843) |
| Adjustments to reconcile net loss to net cash used in operating activities | | |
| Depreciation and amortization | 480,288 | 441,828 |
| Minority interest in net loss of consolidated subsidiary | (735,214) | (224,057) |
| Loss on disposal of fixed assets | — | 5,195 |
| Write-off of deferred financing costs | 167,196 | 214,509 |
| Current charge/(credit) on derivative financial instrument | 10,858 | (15,050) |
| Deferred tax benefit | (74,076) | (74,076) |
| Effect of changes in foreign currency rate | (533,720) | (194,159) |
| Stock-based compensation expense | 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 | (2,847,054) | (886,383) |
| Increase in due from related parties – GXB | (78,199) | (551,049) |
| Increase in inventory | (1,957,665) | (1,706,196) |
| Increase in prepaid expenses and supplies | (278,636) | (446,094) |
| Increase in deferred registration costs | — | (824,856) |
| Increase in other assets | (15,491) | (391,591) |
| (Decrease)/increase in accounts payable, accrued expenses, put warrant payable and derivative instrument | (933,385) | 1,744,724 |
| Increase in due to related parties | 254,691 | 579,245 |
| **Total adjustments** | (5,189,897) | (2,328,010) |
| **NET CASH USED IN OPERATING ACTIVITIES** | (13,472,037) | (8,309,853) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Acquisition of property and equipment | (117,938) | (83,349) |
| Acquisition of intangible assets | (111,931) | (67,359) |
| Business acquisitions – net of cash acquired | — | (13,379) |
| **NET CASH USED IN INVESTING ACTIVITIES** | (229,869) | (164,087) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |

| | | |
|---|---|---|
| Repayment of notes payable | (13,541,011) | (7,588,923) |
| Proceeds from notes payable and warrants | 10,855,070 | 16,232,554 |
| Payments of obligations under capital leases | (1,729) | (2,001) |
| Increase in restricted cash | (94,938) | — |
| Issuance of redeemable convertible preferred stock | — | 2,900,000 |
| Payments for costs of stock issuances | — | (216,023) |
| Issuance of common stock | 31,500,000 | — |
| Payments for costs of stock issuances | (2,898,063) | — |
| **NET CASH PROVIDED BY FINANCING ACTIVITIES** | 25,819,329 | 11,325,607 |
| **EFFECTS OF FOREIGN CURRENCY TRANSLATION** | 32 | (1,094) |
| **NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS** | 12,117,455 | 2,850,573 |
| **CASH AND CASH EQUIVALENTS – BEGINNING** | 1,392,016 | 5,676,398 |
| **CASH AND CASH EQUIVALENTS – ENDING** | **$ 13,509,471** | **$ 8,526,971** |
| **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 initial public offering | $ 28,447,667 | $ — |
| Issuance of common stock in payment of accrued dividends | $ (1,389,765) | $ — |
| Issuance of common stock in initial public offering | $ 1,389,765 | $ — |
| Conversion of 5% euro denominated convertible subordinated notes by issuance of common stock | $ (1,663,173) | $ — |
| Issuance of common stock in initial public offering | $ 1,663,173 | $ — |
| Conversion of 40% of 6% convertible subordinated notes by issuance of common stock | $ (6,000,000) | $ — |
| Issuance of common stock in initial public offering | $ 6,000,000 | $ — |
| Interest paid | $ 629,063 | $ 490,351 |
| 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**
**(Unaudited)**

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## 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 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, 2006 is derived from the March 31, 2006 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, 2006 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. A loss on F/X of $17,659 was realized upon the dissolution. 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 shareholders in exchange for their shares of GSC. Subsequent to the acquisition, The Roaring Water Bay Spirits Group Limited was renamed Castle Brands Spirits Group Limited (‘‘CB Ireland’’) 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.

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. Brands – Vodka — Boru vodka, is an ultra-pure, quintuple distilled and specially filtered premium vodka. Boru is produced in Ireland and has three flavor extensions (citrus, orange and crazzberry).

Rum — Gosling's rums, a family of premium rums with a 200-year history, for which the Company is, through its export venture GCP, the exclusive marketer outside of Bermuda, including the award-winning Gosling's Black Seal rum; and Sea Wynde, a premium rum developed and introduced by the Company in 2001.

Irish Whiskey — Knappogue Castle Whiskey, a vintage-dated premium single-malt Irish whiskey; Knappogue Castle 1951, a pure pot-still whiskey that has been aged for 36 years;



and the Clontarf Irish whiskeys, a family of premium Irish whiskeys, available in single malt, reserve and classic pure grain versions.

Liqueurs/Cordials — Brady's Irish cream, a premium Irish cream liqueur; Celtic Crossing, a premium Irish liqueur; and, pursuant to an exclusive U.S. marketing arrangement, Pallini Limoncello, Raspicello and Peachello premium Italian liqueurs.

C. Principles of consolidation – The consolidated financial statements include the accounts of Castle Brands Inc., its wholly-owned subsidiaries, CB-USA and its wholly-owned foreign subsidiaries, CB Ireland and CB-UK, and its majority owned 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.

D. Organization and operations – The Company is principally engaged in the manufacture, marketing and sale of fine spirit brands of vodka, Irish whiskey, rums and liqueurs (the ‘‘products’’) in the United States, Canada, Europe, and the Caribbean.

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

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 or a control state), 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. Equipment – Equipment consists of office equipment, computers and software and furniture and fixtures. When assets are retired or otherwise disposed of, the cost and related depreciation is removed from the accounts, and any resulting gain or loss is recognized in the statement of operations. Equipment is depreciated using the straight-line method over the estimated useful lives of the assets ranging from three to five years. Depreciation expense for the three months ended September 30, 2006 and 2005 totaled $41,840 and $29,893, respectively and was $78,286 and $57,748 for the six months ended September 30, 2006 and 2005, respectively.

J. 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, 2006 and March 31, 2006, goodwill and other indefinite lived intangible assets that arose from acquisitions were $11.6 million and $11.6 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. The Company evaluates the recoverability of



goodwill and indefinite lived intangible assets using a two-step impairment test approach at the reporting unit level. In the first step the fair value for the reporting unit is compared to its book value including goodwill. In the case that the fair value of the reporting unit is less than the book value, a second step is performed which compares the implied fair value of the reporting unit's goodwill to the book value of the goodwill. The fair value for the goodwill is determined based on the difference between the fair value of the reporting unit and the net fair value of the identifiable assets and liabilities of such reporting unit. If the fair value of the goodwill is less than the book value, the difference is recognized as an impairment. 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 intangible assets and goodwill. The Company concluded that no impairment existed at March 31, 2006. Amortization expense for the three months ended September 30, 2006 and 2005 totaled $203,954 and $190,450, respectively and was $402,002 and $384,080 for the six months ended September 30, 2006 and 2005, respectively.

On September 1, 2006, the Company delivered notice to Comans Wholesale Limited that it was terminating its distribution agreement. As a result of the delivery of the notice, the distribution agreement will terminate, 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. The change in estimated useful life resulted in an additional $8,000 in amortization expense for the quarter ended September 30, 2006.

K. Deferred registration costs – The costs associated with the Company's initial public offering were initially recorded as deferred registration costs then charged to additional paid in capital at the close of the offering on April 10, 2006.

L. Shipping and handling – The Company reflects as inventory costs freight-in and related external handling charges relating to the purchase of raw materials and finished goods. These costs are charged to cost of sales at the time the underlying product is sold. The Company also incurs shipping costs in connection with its various marketing activities, including the shipment of point of sale materials to the Company's regional sales managers and customers, and the costs of shipping product in connection with its various marketing programs and promotions. These shipping charges are included in selling expense. Shipping charges included in selling expense for the three months ended September 30, 2006 and 2005 amounted to $41,968 and $73,020, respectively and were $179,129 and $165,173 for the six months ended September 30, 2006 and 2005, respectively.

M. 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. During the three-month and six-month periods ended September 30, 2006 and 2005, 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, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Sales, net | $ 1,488,077 | $ 902,576 | $ 2,622,016 | $ 1,894,757 |
| Cost of Sales | $ 1,488,077 | $ 902,576 | $ 2,622,016 | $ 1,894,757 |

N. Distributor charges and promotional goods – The Company incurs charges from its distributors for a variety of transactions and services rendered by the distributor, including product depletions, product samples for various promotional purposes, in-store tastings and training where legal, and local advertising where legal. Such charges are reflected as selling expense as incurred. In addition, for certain of its distributors, the Company has entered into arrangements whereby the purchase of a particular product or products by a distributor is accompanied by a percentage of the sale being composed of promotional goods or as a predetermined discount percentage of dollars off invoice. In such cases, the cost of the promotional goods is charged to cost of sales and dollars off invoice are a reduction to revenue.

O. Foreign currency translation – The functional currency for the Company's foreign operations is the euro in Ireland, 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 condensed consolidated statements of operations.

P. Fair value of financial instruments – SFAS No. 107, ''Disclosures About Fair Value of Financial Instruments,'' defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties and requires disclosure of the fair value of certain financial instruments. The Company believes that there is no material difference between the fair value and the reported amounts of financial instruments in the balance sheets due to the short term maturity of these instruments, or with respect to the debt, as compared to the current borrowing rates available to the Company.

Q. Income taxes – Under the asset and liability method of SFAS No. 109 ''Accounting for Income Taxes,'' deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. A valuation allowance is provided to the extent a deferred tax asset is not considered recoverable.

R. Stock-based compensation – Effective April 1, 2006, the Company began recording compensation expense associated with stock options and other forms of equity compensation in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), as interpreted by SEC Staff Accounting Bulletin No. 107. Prior to April 1, 2006, the Company accounted for stock options according to the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and related interpretations, and therefore no related compensation expense was recorded for awards granted with no intrinsic value. The Company adopted the modified prospective transition method provided for under SFAS 123R, and consequently, had not retroactively adjusted results from prior periods. Under this transition method, compensation cost associated with stock options recognized in the three-month and six month periods ended September 30, 2006 includes: 1) amortization related to the remaining unvested portion of all stock option awards granted prior to April 1, 2006 over the requisite service period based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123, *Accounting for Stock-Based Compensation* ; and 2) amortization related to all stock option awards granted on or subsequent to April 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. A compensation charge is recorded when it is probable that performance or service conditions will be satisfied. The probability of vesting is updated annually and compensation is adjusted via a cumulative catch-up adjustment or prospectively depending upon the nature of the change.

As a result of the adoption of SFAS 123R, incremental compensation expense for the three-month and six-month periods ended September 30, 2006 amounted to $276,921 and $771,415, respectively, of which $136,603 and $221,472 is included in selling expense, respectively, and $140,318 and $549,943 in general and administrative expense, respectively, in



the accompanying condensed consolidated statements of operations. At September 30, 2006 total unrecognized compensation cost amounted to approximately $3,339,206, representing 921,433 unvested options.

For stock options granted prior to the adoption of SFAS 123R, if compensation expense for the Company's stock option plan had been determined based upon estimated fair values at the grant dates in accordance with SFAS No. 123, the Company's pro forma net loss and pro forma basic and diluted net loss per common share would have been as follows:

| | For the three-months ended September 30, 2005 | For the six-months ended September 30, 2005 |
|---|---|---|
| Net loss attributable to common stockholders, as reported | $ (3,236,923) | $ (6,673,605) |
| Stock-based compensation expense determined | (60,966) | (171,419) |

| | | |
|---|---|---|
| Pro forma net loss attributable to common stockholders | $ (3,297,889) | $ (6,845,024) |
| Loss per share: Basic and diluted – as reported | $ (1.04) | $ (2.15) |
| Basic and diluted – pro forma | $ (1.06) | $ (2.20) |

S. Research and development costs – The costs of research, development and product improvement are charged to expense as incurred and are included in selling expense.

T. 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, 2006 and 2005 was $1,462,782 and $935,190, respectively and was $2,528,900 and $2,003,765 for the six months ended September 30, 2006 and 2005, respectively.

U. Impairment of long-lived assets – The Company periodically reviews whether changes have occurred that would require revisions to the carrying amounts of its long-lived assets. When the sum of the undiscounted expected future cash flows is less than the carrying amount of the asset, an impairment loss is recognized based on the fair value of the asset.

V. 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, fair value of put warrants, derivative instruments and other equity issuances, allowance for doubtful accounts, depreciation, amortization and expense accruals.

W. Recent accounting pronouncements – In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 108, ‘‘Considering the Effects on Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements,’’ (‘‘SAB 108’’). SAB 108 requires registrants to quantify errors using both the income statement method (i.e. iron curtain method) and the rollover method and requires adjustment if either method indicates a material error. If a correction in the current year relating to prior year errors is material to the current year, then the prior year financial information needs to be corrected. A correction to the prior year results that are not material to those years, would not require a ‘‘restatement process’’ where prior financials would be amended. SAB 108 is effective for fiscal years ending after November 15, 2006. The Company does not anticipate that SAB 108 will have a material effect on its financial position, results of operations or cash flows.

In September 2006, the 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 will be 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.

## 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, contingent conversion of debentures and convertible preferred stock outstanding. In computing diluted net loss per share for the three-month and six-month periods ended September 30, 2006 and 2005, 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 preferred stock and convertible debentures is anti-dilutive.

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

| | September 30, 2006 | 2005 |
|---|---|---|
| Stock options | 1,328,500 | 915,500 |
| Stock warrants | 598,618 | 598,618 |
| Convertible debentures | 1,125,000 | 2,245,505 |
| Convertible preferred stock | — | 4,089,465 |
| Total | 3,052,118 | 7,849,088 |

**NOTE 3 – INVENTORIES**

| | September 30, 2006 | March 31, 2006 |
|---|---|---|
| Raw materials | $ 1,622,458 | $ 1,339,697 |
| Finished goods | 7,154,817 | 5,333,538 |
| Total | $ 8,777,275 | $ 6,673,235 |

As of September 30, and March 31, 2006, 100% of the raw materials and 16.6% and 23.5%, respectively, of finished goods were located outside of the United States.

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

**NOTE 4 – INVESTMENTS AND ACQUISITIONS**

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. GCP had no operations prior to the Company entering into the stock subscription agreement. The original shareholders of GCP were E. Malcolm Gosling and Gosling's Limited and after the Company's purchase of 60% of the ownership interest, the remaining ownership interests were owned 20% by each of E. Malcolm Gosling and Gosling's



Limited. CB-USA had previously entered into an exclusive distribution agreement with Gosling's Export (Bermuda) Limited (“GXB”) to distribute Gosling's rum in the United States. Gosling Partners Inc. had originally been formed to acquire, and had acquired prior to the Company's investment in GCP, the following:

- global distribution rights (excluding Bermuda) to the Gosling's portfolio of products;
- appointment as the exclusive authorized global exporter for the GXB product line;
- an exclusive license for the use of GXB's global trademarks for its brand portfolio;

The Company agreed to pay GCP $5,000,000 for its 60% interest: $100,000 in cash and issuance of a promissory note of $4,900,000 to GCP for the balance owed. This promissory note is payable in five installments as follows:

$1,025,000 on April 1, 2005

$1,125,000 on October 1, 2005

$1,000,000 on April 1, 2006

$1,000,000 on October 1, 2006; and

$750,000 on April 1, 2007

Effective with the payment of the second installment on October 1, 2005, this promissory note began accruing interest on the unpaid principal amount at the rate of 4% per annum until the note is repaid in full. As of September 30, and June 30, 2006, $90,000 and $68,667, respectively, in interest on this note has been accrued and remains unpaid.

The global distribution agreement 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. (See Note 17 — Gosling-Castle Partners Inc. Export Agreement with Gosling's Export (Bermuda) Limited). 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.

**NOTE 5 – RESTRICTED CASH**

In connection with the credit facilities as described in Note 7, personal guarantees of the two former managing directors of CB Ireland and CB-UK in the amount of €158,717 were cancelled and replaced with a deposit of cash collateral of €375,000, or $475,814 and $362,293 (as translated at the exchange rate in effect on September

30, and March 31, 2006, respectively).

**NOTE 6 – OVERDRAFT ACCOUNTS**

CB Ireland and CB-UK maintain overdraft coverage with a financial institution in Ireland of up to €400,000 ($502,000) and £20,000 ($36,300), respectively. Overdraft balances included in notes payable for the periods presented totaled $524,447 and $98,327 at September 30 and March 31, 2006, respectively.



**NOTE 7 – SENIOR NOTES PAYABLE, NOTES PAYABLE AND CAPITAL LEASE**

| | September 30, 2006 | March 31, 2006 |
|---|---|---|
| Notes payable consist of the following: | | |
| Revolving credit facilities (A) | $ 869,025 | $ 332,409 |
| Revolving credit facilities (B) | 66,630 | 166,283 |
| Subordinated notes (C) | — | 307,938 |
| Senior notes (D) | 4,605,088 | 4,594,791 |
| Subordinated convertible notes (E) | 9,000,000 | 15,000,000 |
| Non-interest bearing notes (F) | 625,000 | 1,210,162 |
| 9% Promissory note (G) | — | 2,000,000 |
| | 15,165,743 | 23,611,583 |
| Capital leases | 10,666 | 12,395 |
| Total | $ 15,176,409 | $ 23,623,978 |

(A) The Company has arranged revolving credit facilities aggregating approximately €1,412,303 ($1,791,930) with a lender for working capital purposes. These facilities are payable on demand, continue until terminated by either party on not less than three-months prior written notice, and call for interest at rates ranging from prime plus 3% to 7.85%. The Company also maintains a €190,000 ($241,072) term note with the same lender. The note carries an interest rate of 5.2%, is payable on demand and subject to annual review and renewal by the lender, and calls for monthly payments of principal and interest of €6,377 through 2007.

(B) The Company has arranged revolving credit facilities aggregating approximately £242,000 ($453,236). The facilities, which are payable on demand and subject to annual review and renewal by the lender, call for interest at rates ranging from prime plus 2% to prime plus 2.25%.

(C) In connection with the Company's acquisition of CB Ireland, the Company issued to the former minority shareholders of CB Ireland €255,000 ($307,937) of subordinated notes, which were set to mature on July 11, 2007. The notes accrued interest at the rate of 5.7% per annum with the aggregate interest payable being limited to €51,000 ($61,588). All outstanding principal and accrued interest on these notes in the amount of €290,328 ($350,600) were paid in April 2006.

(D) On June 9, September 28 and October 13, 2004, the Company issued $3,555,000, $1,005,000 and $100,000, respectively, of senior notes secured by accounts receivable and inventories of CB-USA. As issued, these senior notes bore an interest rate of 8%, payable semi-annually on November 30th and May 31st, and matured on May 31, 2007. Effective August 15, 2005, the terms of these notes were modified with the consent of the note holders to mature on May 31, 2009 in exchange for an interest rate adjustment to 9%. In addition, each holder of $1,000 of senior notes received warrants to purchase 25 shares of the Company's common stock at $8.00 per share. At September 30, 2006, there were 116,500 warrants issued and outstanding in conjunction with issuance of senior notes. These warrants have been valued at $129,195 in the aggregate and have been treated as a discount to the notes payable. Interest expense pertaining to this discount is recognized, and the notes payable accreted, over the adjusted term of the notes with a maturity date of May 2009.

(E) On March 1, 2005, the Company entered into an agreement to issue up to $10,000,000 of subordinated convertible notes to a single investor. In June 2005, the Company issued the remaining $5,000,000 of convertible notes. The notes, which mature five years from the date of issuance, bear interest at the rate of 6% per annum which is payable quarterly. The Company has the option for the first two years from the date of issuance to pay interest in kind at the rate of 7.5% per annum. Through September 30, 2006, the Company has accrued and paid all interest in cash at the 6% percent rate pursuant to the terms of the note and has the means and intent to continue to do so. The notes may be converted into common stock at $8 per share at any time, and shall be converted at the option of the holder or automatically after the third year from the date of issuance on the 30th consecutive trading day on which the closing price of the common stock is no less than $20 per share. 40% of the notes converted automatically into common stock upon the completion of the Company's initial public offering on April 10, 2006, at a price of $7.00 per share.

In July 2005, the Company entered into an agreement with an investor to issue $5,000,000 of subordinated convertible notes. The closing was completed in August 2005. The notes, which mature five years from the date of issuance, bear interest at the rate of 6% per annum. The Company has the option for the first two years from the date of issuance to pay interest in kind at the rate of 7.5% per annum. Through September 30, 2006, the Company has accrued and paid all interest in cash at the 6% percent rate pursuant to the terms of the note and has the means and intent to continue to do so. The notes may be converted into common stock at $8 per share at any time, and shall be converted automatically after the third year from the date of issuance on the 30th consecutive trading day on which the closing price of the common stock is no less than $20 per share. 40% of the notes converted automatically into common stock upon the completion of the Company's initial public offering on April 10, 2006, at a price of $7.00 per share.

In July 2005, the original $10,000,000 of convertible notes was amended to be equivalent in terms to those of the new $5,000,000 investor. The automatic conversion of 40% of the combined $15,000,000 of convertible notes at the $7.00 conversion price upon the closing of the initial public offering resulted in the issuance of 107,143 more shares than would have been issued at the $8.00 conversion price.

(F) On February 14, 2005, the Company, through its interest in GCP, entered into an agreement with Gosling's Export (Bermuda) Limited (“GXB”) to acquire the global distribution rights (excluding Bermuda) to GXB's portfolio of products in exchange for $2,500,000 in non-interest bearing notes due in four equal semi-annual installments (See Note 4).

(G) On February 17, 2006, the Company entered into a $5 million credit agreement with an investment trust which is a stockholder and controlled by one of the Company's directors. On February 17, 2006, the Company borrowed $2.0 million under this credit agreement and issued a promissory note bearing interest at the rate of 9% per annum, payable at maturity. In addition, the Company paid a $100,000 facility fee upon receipt of these funds. The Company repaid all outstanding principal and accrued interest under this note in the amount of $2,026,000 in April 2006.

The Company financed the purchase of certain office equipment totaling $17,821 included in equipment. The leases call for monthly payments of $337 in principal and interest at the rate of 5% per annum, to be paid through July 2009. As of September 30, and March 31, 2006, the Company owed $10,666 and $12,395 respectively, under this lease. As of September 30, 2006, future minimum lease payments equal $11,128 including interest.



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Principal payments due over the next five years for the above listed notes payable and capital lease are due as follows (as translated at the exchange rate in effect on September 30, 2006):

| | For the Period ending September 30, |
|---|---|
| 2007 | $ 1,563,941 |
| 2008 | 4,084 |
| 2009 | 3,296 |
| 2010 | 7,605,088 |
| 2011 | 6,000,000 |
| Total | 15,176,409 |
| Less current portion | 1,563,941 |
| Non current portion | $ 13,612,468 |

**NOTE 8 – ROARING WATER BAY NOTES PAYABLE**

In connection with the Company's acquisition of Roaring Water Bay in December 2003 (see Note 1.A), €444,389 ($576,372) of subordinated notes were issued by CB Ireland in substitution of subordinated notes of the same amount originally issued on April 1, 2001 by CB Ireland. The original notes had a maturity date of

April 1, 2006 and were non- interest bearing. The replacement notes were non-interest bearing and the terms called for annual principal payments of €177,743, €133,323 and €133,323 on December 1, 2004, 2005 and 2006, respectively. Interest of 6% was imputed on these notes at the date of acquisition of $56,653. The note discount was accreted monthly by a charge to interest expense. For the three-months ended September 30, 2006 and 2005, the Company recorded interest expense on these notes of $0 and $4,678, respectively. For the six months ended September 30, 2006 and 2005, the Company recorded interest expense on these notes of $11,500 and $9,510 respectively.

The remaining principal amounts due on these notes in the aggregate amount of $159,961 (as translated at the exchange rate in effect on April 20, 2006) were repaid by the Company in April 2006.

In connection with the acquisition of Roaring Water Bay (see Note 1.A) in December 2003, the former principal shareholders received €1,374,750 of convertible subordinated notes in partial consideration for their shares in CB Ireland and CB-UK. These notes were convertible into common shares of the Company at the current conversion price of €5.22, which was subject to adjustment from time to time as set forth in the note agreement. These convertible notes were to mature on December 1, 2006 and had an interest rate of 5% payable quarterly on March 31st, June 30th, September 30th and December 31st. As of March 31, 2006, the Company was indebted in the amount of $1,660,148 on the notes (as translated at the exchange rate in effect on March 31, 2006). These notes converted into 263,362 shares of common stock upon the closing of the initial public offering and $20,726 of accrued interest was paid in April 2006.

**NOTE 9 – COMMON STOCK**

At March 31, 2006, the Company had 3,106,666 common shares outstanding.

On April 5, 2006, the Securities and Exchange Commission declared effective the Company's registration statement on Form S-1 (File No. 333-128676) with respect to the Company's initial public offering. The initial public offering commenced on April 6, 2006 and terminated after all of the registered securities, except for the securities issuable pursuant to the over-allotment option, had been sold. The underwriters in the offering were Oppenheimer & Co. Inc., ThinkEquity Partners LLC and Ladenburg Thalmann & Co. Inc. On April 10, 2006, 3,500,000 shares of common stock were sold on the Company's behalf at an initial public



offering price of $9.00 per share. The Company registered the shares of its common stock in the initial public offering under the Securities Act of 1933, as amended. The Company's registered shares are currently being traded on the American Stock Exchange under the ticker symbol ROX.

Net proceeds to the company after payment of issuance costs not already paid as of April 10, 2006 were $26,533,652, determined as follows:

| | |
|---|---|
| Aggregate offering proceeds to the Company | $ 31,500,000 |
| Underwriting discounts and commissions | 2,205,000 |
| Other fees and expenses | 2,761,348 |
| Total expenses | 4,966,348 |
| Net proceeds to the company | $ 26,533,652 |

The Company has received all final invoices and adjustments incurred in connection with its initial public offering and has paid all balances in full.

In addition, certain transactions occurred at the time of the initial public offering and were settled from the net proceeds of such offering:

- The conversion of all of the Company's outstanding Series A convertible preferred stock into 535,715 shares of common stock;
- The conversion of all of the Company's outstanding Series B convertible preferred stock into 200,000 shares of common stock;
- The conversion of all of the Company's outstanding Series C convertible preferred stock into 3,353,748 shares of common stock;
- 193,107 shares of common stock were issued in payment of all of the dividends accrued on preferred stock through April 9, 2006;
- All of the €1,374,750 ($1,660,148) principal amount of the Company's 5% euro denominated convertible subordinated notes was converted into 263,362 shares of common stock;
- $6.0 million (40%) of the $15.0 million principal amount of the Company's 6% convertible notes was converted into 857,143 shares of common stock;

- Unamortized deferred financing costs incurred in connection with the $6.0 million of 6% convertible notes referred to above were recognized as interest expense;
- €255,000 ($307,937) of subordinated notes were repaid;
- The balance of non-interest bearing shareholder notes payable, including $13,888 of aggregate imputed interest on the original notes, from net offering proceeds ($159,963), adjusted for change in foreign exchange rate at payment date ($1,038) was repaid;
- $2,005,000 of borrowings under the February 2006 credit facility (including $5,000 of interest accrued from April 1, 2006 through April 10, 2006) was repaid;
- $91,222 of accrued interest was paid; and
- $204,952 of all accrued dividends on the preferred membership units of the predecessor company, Great Spirits, LLC was paid.

At September 30, 2006, the Company had 12,009,741 common shares outstanding.



**NOTE 10 – REDEEMABLE CONVERTIBLE PREFERRED STOCK**

The Company had convertible preferred stock outstanding, as follows:

| Description | March 31, 2006 |
|---|---|
| Convertible Preferred Stock, Series A, $1 par value, 550,000 shares authorized, 535,715 shares issued and outstanding; cash dividends at 5%, or accrued dividends at 7% at Company's option, paid semi-annually; 20% redemption per year commencing with sixth anniversary of issuance, automatic conversion to common stock at conversion price of $7 per share upon initial public offering of $10 million or more | $ 3,750,005 |
| Convertible Preferred Stock, Series B, $1 par value, 200,000 shares authorized, issued and outstanding; cash dividends at 5%, or accrued dividends at 7% at Company's option, paid semi-annually, 20% redemption per year commencing with sixth anniversary of issuance, automatic conversion to common stock at conversion price of $6 per share upon initial public offering of $10 million or more | 1,200,000 |
| Convertible Preferred Stock, Series C, $1 par value, 3,353,750 shares authorized, 3,353,750 issued and outstanding at March 31, 2006; cash dividends at 4%, or accrued dividends at 6% at Company's option, paid semi-annually; 20% redemption per year commencing with sixth anniversary of issuance, automatic conversion to common stock at conversion price of $8 per share upon initial public offering of $10 million or more | 26,830,000 |
| (See Note 13 for consideration given to warrant beneficial conversion features) | |
| Subtotal | 31,780,005 |
| Offering costs and value ascribed to warrants | (3,332,322) |
| Net | $ 28,447,683 |

Effective with the Company's initial public offering on April 6, 2006, all of the Company's outstanding Series A convertible preferred stock converted into 535,715 shares of common stock; all of the Company's outstanding Series B convertible preferred stock converted into 200,000 shares of common stock; and all of the Company's outstanding Series C convertible preferred stock converted into 3,353,748 shares of common stock.

**NOTE 11 – 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 March 31, 2006, the Company held outstanding forward exchange positions for the purchase of euros, expiring through July 2006, in the amount of $723,700 with a weighted average conversion rate of €1 = $1.2062 as compared to the spot rate at March 31, 2006 of €1 = $1.2076. At September 30, 2006, the Company had no outstanding forward exchange positions for the purchase of euros. Gain or loss on foreign transactions, which was de minimus, is included in other income and expense.

**NOTE 12 – PROVISION FOR INCOME TAXES**

The Company's income tax benefit for the three-month and six-month periods ended September 30, 2006 and 2005 consists of federal and state and local taxes attributable to



Gosling-Castle Partners Inc. (‘‘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 September 30, 2006 and 2005, the Company recognized $37,038 and $37,038 of deferred tax benefits, respectively, and $74,076 and $74,076 for the six months ended September 30, 2006 and 2005, respectively.

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.

**NOTE 13 – 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. In January 2004, the Board of Directors approved the Plan and the grant of 553,000 options to its full-time U.S. and international employees at an exercise price of $6.00 per share. These options vest over a four or five year period and expire ten years after the grant date.

In connection with the Company's acquisition of CB Ireland and CB-UK, the Company granted to an individual the option to purchase up to 10,000 shares of common stock at an exercise price of $6.00 per share at any time through November 30, 2013.

Stock-based compensation expense recognized in the Statement of for the three-month and six-month periods ended September 30, 2006 amounted to $276,921 and $771,415, respectively. There were no options exercised under all share-based payment arrangements for the six-months ended September 30, 2006.

A summary of the options outstanding under the stock option plan is as follows:

| | Six-months ended September 30, | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Outstanding at beginning of period | 888,500 | $ 6.82 | 745,500 | $ 6.47 |
| Granted | 440,000 | 7.91 | 170,000 | 8.00 |
| Forfeited | — | — | — | — |
| Exercised | — | — | — | — |
| Outstanding at end of period | 1,328,500 | 7.18 | 915,500 | 6.76 |
| Options exercisable at period end | 409,267 | $ 6.63 | 188,533 | $ 6.34 |
| Weighted average fair value of options granted during the period | | $ 3.63 | | $ 3.05 |



The following table represents information relating to stock options outstanding at September 30, 2006:

| | Options Outstanding | | Options Exercisable | |
|---|---|---|---|---|
| Shares | Weighted Average Exercise Price | Weighted Average Remaining Life in Years | Shares | Weighted Average Exercise Price |

| | | | | | Aggregate Intrinsic Value |
|---|---|---|---|---|---|
| 522,000 | $ 6.00 | 7.47 | 257,667 | $ 6.00 | $ 1,153,860 |
| 200,000 | 7.23 | 9.70 | 50,000 | 7.23 | 1,054,000 |
| 100,000 | 7.73 | 9.95 | — | 8.00 | 570,000 |
| 366,500 | 8.00 | 8.47 | 101,600 | 8.00 | 1,117,425 |
| 140,000 | 9.00 | 9.50 | — | 9.00 | 922,600 |
| 1,328,500 | | | 409,267 | | $ 4,817,885 |

As of September 30, 2006, the total stock options outstanding were 1,328,500. The weighted average exercise price of these options was $7.18. The weighted average remaining life of the options outstanding and exercisable was 8.36 and 7.15, respectively. Total stock options exercisable as of September 30, 2006 were 409,267. The weighted average exercise price of these options was $6.63.

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

| | September 30, 2006 | March 31, 2006 |
|---|---|---|
| Risk-free interest rates | 4.93-5.19% | 4.37-4.43% |
| Expected options life in years | 7.00 | 7.00 |
| Expected stock price volatility | 75% | 25% |
| 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 six-months ended September 30, 2006:

| | Shares | Weighted Average Exercise Price |
|---|---|---|
| Nonvested at April 1, 2006 | 586,733 | $ 7.02 |
| Granted | 340,000 | 7.96 |
| Canceled or expired | — | — |
| Vested | (103,500) | 7.32 |
| Nonvested at June 30, 2006 | 823,233 | 7.39 |
| Granted | 100,000 | 7.73 |
| Canceled or expired | — | — |
| Vested | (4,000) | 8.00 |
| Nonvested at September 30, 2006 | 919,233 | $ 7.37 |

As of September 30, 2006, there was $3,339,206 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 8.75 years. The total fair value of shares vested during the three-months and six months ended September 30, 2006 was $32,330 and $437,981, respectively.

The Company did not recognize any tax benefit for the six months ended September 30, 2006 due to the full valuation allowance on its deferred tax assets.



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 the revolving credit facility, the Company granted to the lender, Keltic Financial Partners, LP (“Keltic”), a warrant to acquire 20,000 shares of the Company's common stock at an exercise price of $30. On December 1, 2003, the Company enacted a 5-for-1 split of its common stock. To reflect the effect of this stock split, the warrant was adjusted to grant Keltic the right to acquire 100,000 shares of common stock at an exercise price of $6. 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 Company is 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.

The warrant is exercisable at any time. The holder may convert the warrant, in whole or in part, into the number of shares of common stock determined by multiplying the number of shares under this warrant to be converted by the amount by which (a) the fair market value of one share immediately prior to such exercise exceeds (b) the exercise price in effect immediately prior to such exercise divided by the fair market value of one share in effect immediately prior to such exercise. If the shares are not regularly traded in a public market, the Board of Directors in reasonable good faith judgment shall determine the fair market value as follows: the fair value of the warrant is computed at an amount equal to the Enterprise Value divided by the number of outstanding shares of common stock. If the shares are traded regularly in a public market, the fair market value of a share of common stock shall be the closing sales price of the shares reported for the business day immediately before the holder delivers its conversion notice.

From the date of issuance through September 27, 2005, the warrant contained a put option right that could be exercised by the holder at any time commencing as of September 2006 and ending on the warrant expiration date. Pursuant to that put option right, Keltic had the right to require the Company to purchase the warrant, in whole or in part, for an amount equal to the number of shares as to which Keltic was exercising the put option multiplied by the amount by which (a) the fair market value of one share exceeded (b) the exercise price in effect immediately prior to such exercise of the put option right. The Company would then be obligated to pay the put amount in immediately available funds on the date set; provided however, that if the put amount was greater than $300,000, the Company would pay at least $300,000 on such date and have the option to pay the remainder of the put amount in four equal installments due at the end of each fiscal quarter thereafter, bearing interest at the greater of (a) the prime rate as published by The Wall Street Journal, or in the event that The Wall Street Journal was not available, such rate published in another publication as determined by the holder plus two hundred fifty (250) basis points per annum, or (b) seven percent (7%) per annum, or (c) LIBOR plus five hundred (500) basis points per annum.

The $282,295 fair value assigned to the warrant was recorded as a financing cost reduction in the value assigned to the loan's credit facility (debt discount amount). Such amount was recognized over the three-year life of the credit facility as additional interest expense. The credit facility was closed in June 2004 and the unaccreted balance recognized as additional interest expense at that time.

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. The Company recorded a credit of $18,752 as of September 30, 2005 to reflect the change in fair value of the compound instrument as a result of the amendment discussed below.



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 have not been 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 are shares of common stock received or issuable upon the exercise of the warrant that have not been registered, and (b) it has 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 accounted for the warrant and the registration rights penalty as a derivative following the guidance of EITF 00-19. The Company has concluded that the amendment to the warrant agreement obligating the Company to issue registered shares by the stated dates was dependent both on the Commission's acceptance of the Company's registration and on the underwriters' ability to successfully market the shares. Pursuant to paragraph 14 of EITF 00-19, these factors were beyond the control of the Company and, for this reason, the Company has accounted for the instrument as if it would be required to be net-cash settled.

The Company applied EITF 05-04, View A, concluding that the registration rights are inseparable from the underlying warrant and should be accounted for together as a unit (the delivery of unregistered shares, plus the cash penalty, in exchange for the exercise price) and recorded as a liability at fair value at each reporting date with changes in fair value reported in earnings.

The Company has reflected the fair value of the combined instrument at September 30, and March 31, 2006 included in the balance sheet caption accrued expenses, put warrants payable and derivative instrument of approximately $318,000 and $307,000, respectively.

Common Stock Warrants Issued to Placement Agents

In connection with the issuance of the Series C preferred stock, the Company granted to the placement agent warrants to acquire approximately 192,118 shares of the Company's common stock with an exercise price of $8.00. The warrants are subject to anti-dilution provisions, such as stock splits and stock dividends, vest immediately and expire at various dates from December 2008 through August 2010. The Company is not obligated to register the warrants or the underlying shares, except to the extent that if the Company elects to file a registration statement, the holders can request to have the underlying shares registered. The Company will assume all registration costs and other expenses in connection with such registration.

The proceeds upon issuance of the Series C preferred stock based upon relative fair values were allocated as follows:

| | |
|---|---|
| Value allocated to preferred stock | $ 26,368,971 |
| Value allocated to warrants | 461,029 |
| Gross proceeds of preferred stock | $ 26,830,000 |

The beneficial conversion feature allocated to the warrants was calculated using the Black-Scholes method as the difference between the beneficial conversion price and the fair value of the Company's common stock, multiplied by the number of shares into which the Series C preferred stock was convertible, in accordance with the Emerging Issues Task Force (''EITF'') Issue No. 00-27. The beneficial conversion feature allocated to the warrants was recorded immediately as a deemed dividend and reflected in the net loss attributable to common stockholders and an increase in additional paid-in-capital.

The warrants have conversion rights and can be converted at any time. The holder may convert in whole or in part, into a number of common shares equal to the number of shares under this warrant to be converted, multiplied by the amount by which (a) the fair market value of one share exceeds (b) the exercise price in effect immediately prior to such exercise of the conversion price divided by the fair market value of one share in effect immediately



prior to such exercise of the conversion price. If the shares are not regularly traded in a public market, the Board of Directors in reasonable good faith judgment shall determine the fair market value as follows: the fair value of the warrant is computed at an amount equal to the Enterprise Value divided by the number of outstanding shares of common stock. If the shares are traded regularly in a public market, the fair market value of a share of common stock shall be the closing sales price of the shares reported for the business day immediately before the holder delivers its conversion notice.

Common Stock Warrants Issued to Senior Note Holders

In connection with the issuance of the senior notes in June, September and October 2004, the Company entered into a warrant agreement to grant the right to purchase 116,500 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 fair value and accounted for as a discount of the face value of the senior notes and a credit to additional paid-in capital of $129,195. 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 three-months ended September 30, 2006 and 2005, the Company recorded $5,148 and $7,020, respectively, of senior note accretion as additional interest expense, and $10,296 and $17,784 for the six months ended September 30, 2006 and 2005, 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 fair valued the warrant at $283,727 and recorded a charge upon vesting. The charge is included in interest expense on the accompanying condensed consolidated statements of operations.

Common Stock Warrants Issued in Gosling's Acquisition

In connection with the acquisition of the Company's interest in GCP it agreed to issue warrants to purchase 90,000 shares of common stock at $8.00 per share to three members of the Gosling family and an employee. The Company recorded warrants at fair value as an increase to the purchase price.

The following is a summary of the company's outstanding warrants:

| | Warrants | Weighted Average Exercise Price Per Warrant |
|---|---|---|
| Warrants outstanding, March 31, 2006 | 598,618 | $ 7.67 |
| Granted | — | — |
| Exercised | — | — |
| Forfeited | — | — |
| Warrants outstanding, September 30, 2006 | 598,618 | $ 7.67 |

| | | |
|---|---|---|
| Warrants exercisable, September 30, 2006 | 598,618 | $ 7.67 |

**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 brand, 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 September 30, 2006 and 2005, aggregate charges recorded for all services provided were approximately $64,651 and $63,412, respectively and were $124,358 and $115,466 for the six months ended September 30, 2006 and 2005, 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 shareholder in the Company. Knappogue Corp. is controlled by the Company's CEO and his family. The transactions primarily involved rental fees for use of Knappogue Corp.'s interest in the Knappogue Castle for various corporate purposes including Company meetings and to entertain customers. For the three months ended September 30, 2006 and 2005, the Company recognized $5,000 and $0, respectively, and recognized $5,000 and $7,540 for the six months ended September 30, 2006 and 2005, respectively.

C. In April 2004, the Company contracted with BPW, Ltd., 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, Ltd. is controlled by a director of the Company. The contract provides for a monthly retainer to BPW, Ltd. of $3,500, a bonus payable to BPW Ltd. in equal quarterly installments upon the finalization of an agency brand agreement based upon estimated annual case sales by the Company during the first year of operations at the rate of $1 per 9-liter case of volume, less any retainer previously paid, and a commission based upon actual future sales of the agency brand while under the Company's management. This contract is cancelable by either party, at their convenience, upon 30 days written notice. For the three months ended September 30, 2006 and 2005, the Company recognized $13,220 and $23,000, respectively and $22,546 and $33,500 for the six months ended September 30, 2006 and 2005, respectively, under this contract.

D. For the three months ended September 30, 2006 and 2005, and for the six months ended September 30, 2006 and 2005, the Company purchased goods from Terra Manufacturing Limited (''Terra'') and Carbery Milk Products Limited (''Carbery'') of approximately $692,078, and $608,020, respectively, and $1,101,885 and $1,136,945 respectively. The Company had assumed the underlying supplier agreements with Terra and Carbery from CB-Ireland. Terra's affiliate, Tanis Investments, and Carbery are both shareholders in the Company. As of September 30, 2006 and 2005, the Company was indebted to these two affiliates in the amount of approximately $446,685 and $728,470 respectively, which is included in due to stockholders and affiliates on the accompanying condensed consolidated balance sheet.

E. For the three-months ended September 30, 2006 and 2005, the Company made royalty payments of approximately $9,563 and $9, 604, respectively, and for the six months ended September 30, 2006 and 2005 it made payments of $18,976 and $18,654, 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 consolidated statements of operations. The royalty agreement also includes the right to acquire the patent for the Trinity Bottle for €90,000 ($114,192) for the duration of the licensing period, which expires on December 1, 2008.

F. In February and August 2005, the Company executed agreements with the two Co-Managing Directors of CB Ireland whereby, effective March 11, 2005 and December 1, 2005, respectively, each individual resigned his position in CB Ireland in exchange for a consultancy agreement consisting of fifteen monthly payments totaling €196,875, plus Value Added Tax (‘‘VAT’’). The balance due, net of payments made, was $124,351 and $113,462 at September 30, 2006 and 2005, respectively. In addition, under the terms of these agreements, the stock options of these individuals were deemed to have accrued two years' vesting at the end of the consultancy period, the exercise period for their stock options was extended to December 1, 2008, and the Company agreed to pay off the outstanding balance of their 5% Convertible Subordinated Notes, each dated December 1, 2003, and each in the amount of €465,550 and their Subordinated Note, each dated December 1, 2003, and each in the amount of €133,323 at the earlier of one month following the completion of the Company's initial public offering or in four quarterly installments beginning January 1, 2006. The Company paid the outstanding balance on each of these subordinated notes in the amount of $159,961 on April 19, 2006. The Company also reimbursed these individuals the legal fees incurred in connection with their consultancy agreements in the amounts of €8,000 and €5,000, respectively, plus VAT. For the three-months and six-months ended September 30, 2006 and 2005, the Company made payments of $50,208 and $48,058, respectively and $132,574 and $108,117, respectively, pursuant to these agreements. In September 2005, the Company consented to the sale of the 5% Convertible Notes held by the two Co-Managing Directors of CB Ireland and shares of common stock held by one of the Co-Managing Directors to third parties.

**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 2014, subject to automatic five year extensions thereafter. 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, 2006, the Company has contracted to purchase approximately €654,746 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., 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 as much as five years per renewal period upon Castle Brands achievement of contractual case sale targets. The agreement expires on December 31, 2009.

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. The agreement also encompasses the hiring of a Pallini Brand Manager at Castle Brands with Pallini reimbursing the costs of this position up to a stipulated annual amount. These reimbursements are included in the accompanying consolidated financial statements as a reduction in selling expense and an increase in due from affiliates.



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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 will receive a net sales commission on each case sold. In February 2005, GXB sold its interest in the distribution agreement to Gosling-Castle Partners Inc. (See Note 17).

CB-USA will receive 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 payment to the marketing affiliate, GCP. This distribution agreement is for fifteen years, subject to extension. These reimbursements are included in the accompanying consolidated financial statements as a reduction in selling expense and an increase in due from affiliates.

E. In June 2004, the Company executed subleases for office space in Dublin, Ireland and midtown Manhattan. The Dublin office lease commenced on June 1, 2004 and extends through February 28, 2009. Rent is payable quarterly in advance. The New York City lease commenced on August 15, 2004 and extends through March 30, 2008. The Houston, Texas lease commenced on February 24, 2000 and extends through March 31, 2007. 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 September 30, | Amount |
|---|---|
| 2007 | $ 300,864 |
| 2008 | 139,866 |
| 2009 | 4,962 |
| 2010 | 1,012 |
| Total | $ 446,704 |

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 $105,026 and $99,221 for the three-months ended September 30, 2006 and 2005, respectively, and $197,983 and $184,150 for the six months ended and September 30, 2006 and 2005, 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 brand in the United States, has the option to purchase 70% of the brand 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 condensed consolidated statements of operations.

G. Pursuant to a composite inter-company guarantee in the amount of €860,000 ($1,091,168) completed in February 2005 between the Company, Castle Brands Spirits Company Limited and Castle Brands Spirits (GB) Limited, the Company has guaranteed the loans from Ulster Bank to the Company's European subsidiaries.

H. The Company is subject to strict federal and state government regulations associated with the marketing, import, warehouse, transport, and distributions of spirits.



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**NOTE 16 – CONCENTRATION OF CREDIT RISK**

The Company maintains its cash balances at various large financial institutions that, at times, may exceed federally and internationally insured limits. As of September 30, and March 31, 2006, the Company exceeded the insured limit by approximately $13,590,000 and $1,300,000, respectively. 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.

**NOTE 17 – GOSLING-CASTLE PARTNERS INC. EXPORT AGREEMENT WITH GOSLING'S EXPORT (BERMUDA) LIMITED**

In February 2005, Gosling-Castle Partners Inc. secured the GXB global distribution rights under an Export Agreement (the ‘‘Agreement’’) with GXB. This agreement calls for GCP to pay $2,500,000 to GXB for the assignment of its global distribution rights in four equal installments at April 1, 2005, October 1, 2005, April 1, 2006 and October 1, 2006. The discounted note has been fully accreted at September 30, 2006. For the three-months ended September 30, 2006 and 2005, the Company recognized interest expense of $19,919 and $19,919, respectively. For the six-months ended September 30, 2006 and 2005, the Company recognized interest expense of $39,838 and $39,838, respectively, on this note.

In addition, under the terms of the Export Agreement, GXB has agreed to sell all brands in its portfolio to GCP at its manufacturer's cost plus a specified producer's profit. For the years of the agreement, the producer's profit is a stipulated amount per case, adjusted for certain documented cost increases.

The Export Agreement gives GCP the right of first refusal to purchase, in the event GXB decides to sell any or all of its trademarks or other intellectual property, at the same price being offered by a bona fide third party offeror. In the event GCP waives its right of first refusal, the Company has an identical right of first refusal. Furthermore, in the event GXB should decide to sell any or all of its portfolio of products either directly or indirectly through the sale of stock of GXB or its parent company to a third party, the agreement contains a formula for GCP to share in the proceeds of the sale of the brand with such share in the sale proceeds up to a stipulated percentage depending upon the number of nine liter equivalent cases of product sold by GCP in the twelve months preceding the sale.

The Export Agreement 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 as set forth in the Agreement.

**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. The Company reports its operations in two geographic areas: International and United States.

The consolidated financial statements include revenues and assets generated in or held in foreign countries. The following table sets forth the percentage of consolidated revenue from continuing operations and consolidated assets from foreign countries.



| | For the three-months ended September 30, | | | | For the six-months ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | 2005 | | 2006 | | 2005 | |
| Consolidated Revenue: | | | | | | | | |
| International | $1,969,140 | 31.5% | $1,682,313 | 32.5% | $3,852,184 | 32.9% | $3,468,009 | 34.4% |
| United States | 4,282,922 | 68.5% | 3,492,831 | 67.5% | 7,860,283 | 67.1% | 6,623,529 | 65.6% |
| Total Consolidated Revenue | $6,252,062 | 100% | $5,175,144 | 100% | $11,712,467 | 100% | $10,091,538 | 100% |
| Consolidated Depreciation and Amortization | | | | | | | | |
| International | $19,353 | 7.9% | $19,327 | 8.8% | $38,295 | 8.0% | $39,536 | 8.9% |
| United States | 226,441 | 92.1% | 201,016 | 91.2% | 441,993 | 92.0% | 402,292 | 91.1% |
| Total Consolidated Depreciation and Amortization | $245,794 | 100% | $220,343 | 100% | $480,288 | 100% | $441,828 | 100% |
| Income Tax Benefit | | | | | | | | |
| United States | $37,038 | 100% | $37,038 | 100% | $74,076 | 100% | $74,076 | 100% |
| Revenues by Category: | | | | | | | | |
| Vodka | $2,024,189 | 32.4% | $1,564,501 | 30.2% | $3,862,152 | 33.0% | $3,319,926 | 32.9% |
| Rum | 2,138,809 | 34.2% | 1,693,166 | 32.7% | 3,944,885 | 33.7% | 3,437,765 | 34.1% |
| Liqueurs/Cordials | 1,329,587 | 21.3% | 1,158,685 | 22.4% | 2,379,712 | 20.3% | 1,894,433 | 18.8% |
| Whiskey | 692,590 | 11.1% | 742,240 | 14.4% | 1,420,673 | 12.1% | 1,422,862 | 14.1% |
| Other* | 66,887 | 1.0% | 16,552 | 0.3% | 105,045 | 0.9% | 16,552 | 0.1% |
| Total Consolidated Revenue | $6,252,062 | 100% | $5,175,144 | 100.0% | $11,712,467 | 100% | $10,091,538 | 100.0% |
| Consolidated Assets: | | | | | | | | |
| International | $6,027,458 | 10.4% | | | | | | |
| United States | 51,830,254 | 89.6% | | | | | | |
| Total Consolidated Assets | $57,857,712 | 100.0% | | | | | | |

* Includes related food products.

**NOTE 19 – SUBSEQUENT EVENTS**

On October 12, 2006, the Company acquired all of the outstanding capital stock of McLain & Kyne, Ltd. (‘‘McLain & Kyne’’), pursuant to a Stock Purchase Agreement among Chester F. Zoeller III, Brittany Lynn Zoeller Carlson, Beth Allison Zoeller Willis (collectively, the ‘‘Sellers’’) and the Company (the ‘‘Agreement’’). McLain & Kyne is a Louisville, Kentucky based developer and marketer of three premium small batch bourbons: Jefferson's, Jefferson's Reserve and Sam Houston. As consideration for the acquisition, the Company has paid $1,294,800 in cash to the Sellers and will issue to the Sellers 100,000 shares of its common stock. 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.

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

On November 10, 2006, CB-USA issued to 11 individuals an aggregate of $5,340,000 of additional senior notes secured by accounts receivable and inventories of CB-USA. These notes mature on May 31, 2009 and bear interest at 9% payable semi-annually. In addition, each holder of senior notes received warrants to purchase 40 shares of the Company's



common stock at $8.00 per share for each $1,000 of additional senior notes purchased by such holder. There were 213,600 warrants issued in conjunction with the issuance of the additional senior notes. These warrants have been valued at $814,814 and will be treated as a discount to the notes payable. Interest expense pertaining to this discount will be recognized, and the notes payable accreted, over the term of the notes with a maturity of May 2009.

**NOTE 20 – ACCOUNTING FOR DERIVATIVE INSTRUMENT, THE INCREASING RATE DIVIDEND ON THE SERIES C PREFERRED STOCK AND AMORTIZATION OF DEFINITE LIVED INTANGIBLE ASSET — REVISION**

The Company has revised the accompanying financial statements to reflect as a liability the fair value of a derivative instrument (put warrant issued December 1, 2003) (see Note 13). Such recomputation of the fair value of the derivative instrument resulted in a change for the six-months ended September 30, 2005. The fair value of the derivative instrument at December 1, 2003 was $282,295. The Company has recorded the changes in fair value of the derivative financial instrument at each reporting period presented in the Statement of Operations.

The Company has revised the accompanying financial statements to reflect the fair value of Series C Preferred Stock from the date of issuance. As issued, the Series C Preferred Stock did not accrue dividends until December 1, 2005. Increasing rate preferred stock is initially recorded at fair value and the discount amortized over the period preceding the commencement of the perpetual dividend by recording a deemed dividend and increasing the carrying amount of the preferred stock by a corresponding amount. The fair value of the Series C Preferred Stock deemed dividend at December 1, 2003 was $1,259,262. The amortization on the Series C Preferred Stock resulted in a change for the six-months ended September 30, 2005.

The Company has revised the accompanying financial statements to reflect the amortization of certain intangibles which have been reclassified from indefinite lived assets to intangible assets with an estimated life of five years and ten years, respectively. The amortization of the intangibles resulted in a change for the six-months ended September 30, 2005.

The following table summarizes the recomputation of fair value on the derivative instrument, the increasing rate dividend on Series C Preferred Stock at December 1, 2003 and the amortization of the reclassified definite lived intangible assets.

| | As previously reported | As revised | Adjustment |
|---|---|---|---|
| Value of derivative instrument | $ 0 | $ 282,295 | $ 282,295 |
| Fair value of Series C Preferred Stock deemed dividend | $ 0 | $ 1,259,262 | $ 1,259,262 |
| Amortization of definite lived intangibles | $ 0 | $ 247,633 | $ 247,633 |



Net loss, preferred stock and preferred membership unit dividends and net loss attributable to common stockholders for all periods presented were amended as follows as a result of the above revisions:

| | Net loss | Preferred stock and preferred membership unit dividends | Net loss attributable to common stockholders | Net loss per common share attributable to common stockholders basic and diluted |
|---|---|---|---|---|
| As previously reported September 30, 2005 | $ (5,918,693) | $ 202,579 | $ (6,121,272) | $ (1.97) |
| Current credit/(charge) on derivative instrument | 15,050 | | 15,050 | 0.01 |

| | | | | |
|---|---|---|---|---|
| Increasing rate dividend on Series C Preferred Stock | | 489,183 | (489,183) | (0.16) |
| Amortization of definite lived intangibles | (78,200) | | (78,200) | (0.03) |
| As revised, September 30, 2005 | $ (5,981,843) | $ 691,762 | $ (6,673,605) | $ (2.15) |



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

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,'' ''expects,'' ''intends,'' ''plans,'' ''anticipates,'' ''believes,'' ''thinks,'' ''estimates,'' ''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, without limitation, 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; our ability to fully utilize and retain new executives; 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 impact of federal, state, local or foreign government regulations; the effect of competition in our industry; and economic and political conditions generally; and the other factors listed under the caption ''Risk Factors'' in our Annual Report on Form 10-K for the year ended March 31, 2006 and elsewhere in this report.

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.

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, 2006, 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, Irish whiskey, liqueurs/cordials, and beginning in October 2006, bourbon. We distribute these spirits in all 50 U.S. states and the District of Columbia, in six key international markets: Ireland, Great Britain, Germany, France, Italy and Canada, and in a number of other countries in continental Europe. Our brands include, among others, Boru vodka, Gosling's rums, Knappogue Castle Whiskey and the Pallini liqueurs.

Our current growth strategy focuses on: (a) aggressive brand development to encourage case sale 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.

For the three-months ended September 30, 2006, our total net sales increased $1.1 million, to $6.3 million, representing a 20.8% increase when compared against $5.2 million in the comparable prior year period. This increase was driven by organic growth of our existing brands, led by Boru vodka and Gosling's rums.



In the same period, selling expense increased $1.5 million, to $4.7 million, representing a 46.1% increase when compared against $3.2 million in the comparable prior year period, due primarily to volume driven increases in distributor incentives, sales support expense, selling related shipping costs and sales commissions as well as billboard and print media advertising expenses pertaining to a recent Gosling's rum advertising campaign.

General and administrative expense increased $0.7 million, or 53.6%, to $1.9 million for the three-months ended September 30, 2006 versus $1.2 million in the comparable prior year period primarily due to increased financial printing charges incurred in connection with our change in status to a public company, as well as to increases in compensation expense, our D&O liability insurance expense and travel and entertainment expenses. Depreciation and amortization remained approximately the same as the same period in 2005.

***Case Sales***

The following table sets forth certain information regarding our case sales for the three and six month periods ended September 30, 2006 and 2005. The data in the following table is based on nine-liter equivalent cases, which is a standard spirits industry metric.

| | Three-months Ended September 30, | | Six-months Ended September 30, | |
|---|---|---|---|---|
| **Case Sales** | **2006** | **2005** | **2006** | **2005** |
| **Cases** | | | | |
| United States | 48,107 | 41,294 | 90,637 | 73,972 |
| International | 32,011 | 29,645 | 59,976 | 57,913 |
| Total | 80,118 | 70,939 | 150,613 | 131,885 |
| Vodka | 39,172 | 31,486 | 73,036 | 63,273 |
| Rum | 23,122 | 18,991 | 42,985 | 37,123 |
| Liqueurs/cordials | 13,207 | 15,687 | 25,112 | 22,791 |
| Whiskey | 4,617 | 4,775 | 9,480 | 8,698 |
| Total | 80,118 | 70,939 | 150,613 | 131,885 |
| **Percentage of Cases** | | | | |
| United States | 60.1% | 58.2% | 60.2% | 56.1% |
| International | 39.9% | 41.8% | 39.8% | 43.9% |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| Vodka | 48.9% | 44.4% | 48.5% | 48.0% |
| Rum | 28.9% | 26.8% | 28.5% | 28.1% |
| Liqueurs/cordials | 16.4% | 22.1% | 16.7% | 17.3% |
| Whiskey | 5.8% | 6.7% | 6.3% | 6.6% |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |



**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 September 30, | | Six-months Ended September 30, | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Sales, net | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of sales | 67.7 | 61.1 | 66.6 | 62.6 |
| Gross profit | 32.3 | 38.9 | 33.4 | 37.4 |
| Selling expense | 75.1 | 62.1 | 70.3 | 62.9 |
| General and administrative expense | 30.4 | 23.9 | 35.3 | 23.5 |
| Depreciation and amortization | 3.9 | 4.3 | 4.1 | 4.4 |
| Loss from continuing operations | (77.1) | (51.4) | (76.3) | (53.4) |
| Other income | 0.0 | 0.7 | 0.0 | 0.3 |
| Other expense | (0.2) | (0.2) | (0.1) | (0.2) |
| Foreign exchange gain/(loss) | 4.2 | 0.3 | 5.6 | (3.0) |
| Interest expense, net | (1.2) | (7.1) | (4.3) | (6.2) |
| Write-off of deferred financing costs in connection with conversion of 6% subordinated convertible notes | | | (2.5) | |
| Current credit/(charge) on derivative financial instrument | (0.1) | 0.0 | (0.1) | 0.1 |
| Income tax benefit | 0.6 | 0.7 | 0.6 | 0.7 |
| Minority interests | 6.3 | 1.8 | 6.3 | 2.2 |
| Net loss | (67.5) | (55.2) | (70.8) | (59.5) |

| | | | | |
|---|---|---|---|---|
| Less: | | | | |
| Preferred stock dividends | 0.0 | 7.5 | 0.4 | 6.9 |
| Net loss attributable to common stockholders | (67.5)% | (62.7)% | (71.2)% | (66.4)% |

**Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005**

*Net sales.* Net sales increased $1.1 million, or 20.8%, to $6.3 million in the fiscal quarter ended September 30, 2006 versus $5.2 million in the comparable 2005 period. This increase reflected an increase in case sales of our existing brands. This increase also reflected that the average sales price per case increased $5.09, or 7.0%, due primarily to the favorable sales mix in the current quarter which included a greater proportion of Pallini and Celtic Crossing liqueurs and Gosling's rums, than in the comparable prior year period. There was no material change in the selling prices of our existing products between the three-months ended September 30, 2006 and the comparable prior period in 2005. Our case sales, measured in nine-liter case equivalents, increased 9,179 cases, or 12.9%, to 80,118 cases versus 70,939 cases in the comparable prior period, driven by growth in our products in three of our primary categories as follows:

- 7,686 additional cases of vodka;
- 4,131 additional cases of rum, primarily Gosling's; and
- 2,576 additional cases of liqueurs, primarily Pallini;

This was offset by a 5,056 case decline in sales of our Irish creams and a 158 case decline in sales of our Irish whiskey.

Our overall U.S. case sales as a percentage of total case sales increased to 60.1% during the three-months ended September 30, 2006 from 58.2% in the comparable prior year period. This increase of 6,813 cases, representing 74.2% of the total quarterly increase in case sales globally, reflects the relative growth opportunities within the United States for our premium spirits portfolio, particularly Gosling's rums, Pallini liqueurs, and Boru vodka.



The table below presents the increase in our case sales by product category for the three-months ended September 30, 2006 compared to the comparable 2005 period.

| | Increase (decrease) in case sales | | Percentage Increase (decrease) | |
|---|---|---|---|---|
| | Overall | U.S. | Overall | U.S. |
| Vodka | 7,686 | 2,809 | 24.4% | 22.4% |
| Rum | 4,131 | 3,768 | 21.7% | 24.4% |
| Liqueurs/cordials | (2,480) | (198) | (15.8%) | (1.5%) |
| Irish Whiskey | (158) | 434 | (3.3%) | 59.3% |
| Total | 9,179 | 6,813 | 12.9% | 16.5% |

*Gross profit.* Gross profit was flat at $2.0 million during the three-months ended September 30, 2006, matching the gross profit of the comparable 2005 period. While net sales increased as compared to the prior year period, gross profit remained flat due to an increase in our cost of sales. Cost of sales increased in the current period due to increases in the costs of raw materials and product packaging, as well as a higher cost sales mix and certain higher margin ''one-off'' sales that occurred in 2005. In addition, price sensitivity and competition in many of our markets have prevented us from passing increased costs of sales to our customers at this time. As a result of these factors, the current period saw a drop in gross margin percentage to 32.3% from 38.9% in the comparable prior year period.

*Selling expense.* Selling expense increased 46.1% to $4.7 million during the three-months ended September 30, 2006 versus $3.2 million in the comparable prior year period. The change in selling expense was primarily attributable to increases in distributor incentives and sales support costs of $0.4 million. In addition, the Gosling rum advertising campaign incurred charges of $1.0 million in the quarter ended September 30, 2006 versus $0.4 million in the comparable prior year period. Compensation expense increased by $0.3 million due, in part, to the impact of the hiring of our Managing Director – Americas and Senior Vice President of Global Strategic Planning as well as to the hiring of several additional full time employees during the current fiscal year who replaced part-time employees or interns. This increase also reflects stock-based compensation expense of $0.1 million due to our adoption of SFAS 123(R), Share-Based Payment. As a percentage of net sales, selling expense increased to 75.1% compared to 62.1% for the comparable prior year period.

*General and Administrative Expense.* General and administrative expense increased 53.6% to $1.9 million during the three-months ended September 30, 2006 versus $1.2 million in the comparable period in 2005. Major components of this increase included an increase of $0.1 million in professional fees which were primarily attributable to our change in status to that of a public company and an increase of $0.2 million in compensation expense due to the full current period impact of salaries and benefits for several executive and administrative employees hired in the past 12 months versus the comparable period in 2005. This increase also reflects a $0.2 million charge for stock-based compensation expense resulting from our adoption of SFAS 123(R) effective April 1, 2006 and an increase of $0.2 million incurred for public company directors and officers' liability insurance. As a percentage of net sales, general and administrative expense increased to 30.4% for the three-months ended September 30, 2006 compared to 23.9% for the comparable period in 2005.

*Depreciation and Amortization.* Depreciation and amortization during the quarter ended September 30, 2006 was approximately the same as the comparable prior year quarter at $0.2 million and is primarily attributable to amortization of the Gosling worldwide (except Bermuda) distribution agreement which went into effect during February 2005.

*Other Income/(Expense), Net.* Other income/(expense), net, increased to $0.6 million during the three-months ended September 30, 2006 versus ($0.2) million in the comparable 2005 period. The major components of this category include the following:



- Foreign exchange gain during the three-months ended September 30, 2006 was $0.3 million versus a nominal gain in the comparable prior year period. The current period gain is attributable to the effects of the strengthening of the euro against the dollar on our intercompany loans to our foreign subsidiaries;
- Interest income during the three-months ended September 30, 2006 was $0.2 million versus zero in the comparable period in 2005. The source of this income is investment of the proceeds of our initial public offering;
- Interest expense during the three-months ended September 30, 2006 remained flat from the comparable period in 2005 at $0.3 million and pertained to our senior notes, the $9.0 million of 6% convertible subordinated notes outstanding following our initial public offering and financing costs on our accounts receivable discounting arrangement with a bank in Ireland; and
- Minority interest during the three-months ended September 30, 2006 amounted to a credit of $0.4 million versus a credit of $0.1 million in the comparable 2005 period as a result of a larger loss recorded by our 60%-owned subsidiary, Gosling-Castle Partners, Inc.

*Net Loss Attributable to Common Stockholders.* The net loss attributable to common stockholders for the three-months ended September 30, 2006 increased 30.3% to $4.2 million versus $3.2 million in the comparable 2005 period. These net losses included $0 and $0.4 million of preferred stock dividends accrued during the three-months ended September 30, 2006 and 2005, respectively. The primary factors impacting our net loss for the three-months ended September 30, 2006 were the increase in selling and general and administrative expenses, including our first-time recognition of stock based compensation expense in the current period.

**Six Months Ended September 30, 2006 Compared to Six Months Ended September 30, 2005**

*Net sales.* Net sales increased $1.6 million, or 16.1%, to $11.7 million in the six months ended September 30, 2006 versus $10.1 million in the comparable 2005 period. This increase reflected an increase in case sales of our existing brands. Average sales price per case increased $1.25, or 1.6%, due primarily to the favorable sales mix in the current period which included a greater proportion of Pallini and Celtic Crossing liqueurs and Gosling's rums sold than in the comparable 2005 period. There was no material change in the selling prices of our existing products between the six-months ended September 30, 2006 and the comparable prior period in 2005. Our case sales, measured in nine-liter case equivalents, increased 18,728 cases, or 14.2%, to 150,613 cases versus 131,885 cases in the comparable prior period, with the increase comprised of:

- 9,763 additional cases of vodka;
- 5,862 additional cases of rum, primarily Gosling's;
- 2,321 additional cases of creams and liqueurs, primarily Pallini;
- 782 additional cases of Irish whiskey

Our U.S. case sales as a percentage of total case sales increased to 60.2% during the six-months ended September 30, 2006 from 56.1% in the comparable prior year period. This increase of 16,665 cases, representing 89.0% of the total six-month increase in case sales globally, reflects the relative growth opportunities within the United States for our premium spirits portfolio, particularly Gosling's rums, Pallini liqueurs, and Boru vodka.



The table below presents the increase in our case sales by product category for the six months ended

September 30, 2006 compared to the comparable 2005 period.

| | Increase (decrease) in case sales | | Percentage Increase (decrease) | |
|---|---|---|---|---|
| | Overall | U.S. | Overall | U.S. |
| Vodka | 9,763 | 6,719 | 15.5% | 29.2% |
| Rum | 5,862 | 4,477 | 15.8% | 14.7% |
| Liqueurs/cordials | 2,321 | 4,791 | 10.2% | 25.4% |
| Irish Whiskey | 782 | 678 | 9.0% | 40.5% |
| Total | 18,728 | 16,665 | 14.2% | 22.5% |

*Gross profit.* Gross profit increased 3.7% to $3.9 million during the six-months ended September 30, 2006 versus $3.8 million in the comparable 2005 period. Cost of sales increased in the current period due to increases in the costs of raw materials and product packaging, as well as a higher cost sales mix. In addition, price sensitivity and competition in many of our markets have prevented us from passing on increased costs of sales to our customers at this time. As a result of these factors, the current period saw a drop in gross margin percentage to 33.4% from 37.4% in the comparable prior year period.

*Selling expense.* Selling expense increased 29.7% to $8.2 million during the six-months ended September 30, 2006 versus $6.3 million in the comparable 2005 period. The change in selling expense was primarily attributable to increases in distributor incentives and sales support costs of $0.5 million and to an aggregate increase of $0.1 million in selling related shipping costs and sales commissions. In addition, the Gosling rum advertising campaign incurred charges of $1.0 million in the six-months ended September 30, 2006 versus $0.4 million in the comparable prior year period. In addition, sales consulting expense increased approximately $0.1 million in the six-months ended September 30, 2006 and was employed to further enhance our strategic brand marketing platforms and to execute the new Boru bottle design in time for a re-launch of the brand in fiscal 2007.Compensation expense increased by $0.5 million due, in part, to impact of the hiring of our Senior Vice President and Managing Director, International Operations and our Managing Director – Americas and Senior Vice President of Global Strategic Planning, as well as to the hiring of several additional full time employees during the current fiscal year who replaced part-time employees or interns. This increase also reflects stock-based compensation expense of $0.2 million due to our adoption of SFAS 123(R), Share-Based Payment. These increases were offset, in part, by a reduction of $0.1 million in travel and entertainment expenses during the six months ended September 30, 2006. As a percentage of net sales, selling expense increased to 70.3% compared to 62.9% for the comparable prior year period.

*General and Administrative Expense.* General and administrative expense increased 74.2% to $4.1 million during the six months ended September 30, 2006 versus $2.3 million in the comparable period in 2005. Major components of this increase included an increase of $0.2 million in professional fees which were primarily attributable to our change in status to that of a public company, an increase of $0.8 million in compensation expense due to the full current period impact of salaries and benefits for several executive and administrative employees hired in the past 12 months versus the comparable period in 2005. This increase also reflects a $0.5 million charge for stock-based compensation expense resulting from our adoption of SFAS 123(R) effective April 1, 2006 and an increase of $0.3 million incurred for public company directors and officers' liability insurance. As a percentage of net sales, general and administrative expense increased to 35.3% for the six months ended September 30, 2006 compared to 23.5% for the comparable prior year period.

*Depreciation and Amortization.* Depreciation and amortization increased 9% to $0.5 million during the six-months ended September 30, 2006 versus $0.4 million in the comparable prior year period and is primarily attributable to amortization of the Gosling worldwide (except Bermuda) distribution agreement which went into effect during February 2005.

*Other Income (Expense), Net.* Other income/(expense), net, increased to $0.7 million during the six-months ended September 30, 2006 versus ($0.6) million in the comparable period in 2005. The major components of this category include the following:



- Foreign exchange gain / (loss) during the six-months ended September 30, 2006 was a gain of $0.7 million versus a loss of ($0.3) million in the comparable period in 2005. The current period gain is attributable to the effect of a strengthening of the euro against the dollar on our intercompany loans to our foreign subsidiaries;
- Interest income during the six-months ended September 30, 2006 was $0.4 million versus zero in the comparable period in 2005. The source of this income is investment of the proceeds of our initial public offering;
- Interest expense during the six-months ended September 30, 2006 was $0.8 million versus $0.6 million in the comparable period in 2005 and pertained to our senior notes, the $9.0 million of 6% convertible subordinated notes outstanding following our initial public offering and financing costs on our accounts receivable discounting arrangement with a bank in Ireland;

- Write-off of deferred financing costs of $0.3 million in connection with the conversion to common stock of 40% of our 6% convertible subordinated notes; and
- Minority interest during the six-months ended September 30, 2006 amounted to a credit of $0.7 million versus a credit of $0.2 million in the comparable 2005 period as a result of a larger loss recorded by our 60%-owned subsidiary, Gosling-Castle Partners, Inc.

*Net Loss Attributable to Common Stockholders.* The net loss attributable to common stockholders for the six-months ended September 30, 2006 increased 24.8% to $8.3 million versus $6.7 million in the comparable 2005 period. These net losses included $0.1 million and $0.7 million of preferred stock dividends accrued during the six-months ended September 30, 2006 and 2005, respectively. The primary factors impacting our net loss for the six-months ended September 30, 2006 were the increase in selling and general and administrative expenses, the expensing of deferred financing charges associated with the automatic conversion to common stock of 40% of our 6% convertible notes at the time of our initial public offering, our first-time recognition of stock based compensation expense in the six-month period ending September 30, 2006, our foreign exchange gain versus a loss in the comparable prior year period and the effects of an increase in losses by our 60%-owned subsidiary, Gosling-Castle Partners Inc.

*EBITDA.* EBITDA decreased 12.8% to negative $6.2 million for the six-months ended September 30, 2006 versus negative $5.5 million the comparable prior year period. EBITDA represents net income before deducting interest expense (including expensing of deferred financing costs), income taxes, depreciation and amortization and the impact of the non-cash charge for stock-based compensation reported under SFAS 123(R). We use EBITDA as the primary internal management measure for evaluating performance on a period over period analysis, when comparing actual results to budgeted performance and when allocating additional resources. This non-GAAP financial measure is presented in order to assist industry analysts and investors in assessing our liquidity, our ability to incur and service debt, make capital expenditures and meet working capital requirements. EBITDA should not be considered as an alternative to operating income as an indicator of our performance, as an alternative to cash flows from operating activities as a measure of liquidity, or as an alternative to any other measure determined in accordance with GAAP. Unlike net income, EBITDA does not include depreciation or interest expense and therefore does not reflect current or future capital expenditures or the cost of capital. We compensate for these limitations by using EBITDA as only one of several comparative tools, together with GAAP measurements, to assist in the evaluation of operating performance. Such GAAP measurements include operating income (loss), net income (loss), cash flows from operations and cash flow data. We have significant uses of cash flows, including interest payments, debt principal repayments, and other non-recurring charges, which are not reflected in EBITDA. Because EBITDA as determined by us excludes some, but not all, items that affect net income, it may not be comparable to EBITDA or similarly titled measures used by other companies.



The following table sets forth our reconciliation of EBITDA to net loss (the most directly comparable financial measure):

| | Six-months Ended September 30, | |
|---|---|---|
| **(Dollars in thousands)** | **2006** | **2005** |
| Net loss | $ (8,282) | $ (5,982) |
| Add (subtract): | | |
| Income tax benefit | (74) | (74) |
| Interest expense, net, including expensing of deferred financing costs | 794 | — |
| Depreciation and amortization | 480 | 442 |
| Stock based compensation | 771 | — |
| EBITDA | $ (6,311) | $ (4,990) |

**Liquidity and Capital Resources**

Since our inception, we have incurred significant operating and net losses and, in addition, have not generated positive cash flows from operations. As of September 30, 2006, we had stockholders' equity of $30.3 million and working capital of $21.7 million. At March 31, 2006 (prior to our initial public offering in April 2006), we had a stockholders' deficit of $26.0 million and a working capital deficit of $0.8 million. At September 30, 2006, we had cash and cash equivalents of approximately $13.5 million. At March 31, 2006, we had cash and cash equivalents of approximately $1.4 million. The increase in stockholders' equity, working capital and cash and cash equivalents is due to our initial public offering which raised gross proceeds of $31,500,000 upon the sale of 3,500,000 common shares at the offering price of $9.00 per share. Total estimated offering costs were $4,966,348. Upon the closing of our initial public offering, we received net proceeds from the offering of approximately $26.5 million. We have received all final invoices and adjustments incurred in connection with our initial public offering and have paid all balances in full. The proceeds have been and will continue to be used for working capital and general corporate purposes, including for sales and marketing activities, meeting capital commitments to our 60%-owned subsidiary, Gosling-Castle Partners Inc., the hiring of additional employees and repayment of debt and related interest.

In addition, at September 30, 2006, we had approximately $0.5 million of cash restricted from withdrawal and held by a bank in Ireland as collateral for a line of credit.

The following trends are reasonably likely to result in a material decrease in our liquidity over the near-to-mid term:

- an increase in working capital requirements to finance higher levels of inventories and accounts receivable;
- addition of administrative and sales personnel as our business expands;
- increases in advertising, public relations and sales promotions for existing and new brands;
- acquisition of additional spirits brands;
- an increase in legal, accounting and other expenses due to our new status as a public company;
- a reduction in gross margin due to increases in our cost of sales which are not fully passed on to our customers in the form of higher selling prices for our products;
- financing the operations of our 60%-owned Gosling-Castle Partners strategic export venture; and
- expansion into new markets and within existing markets in the United States and internationally.

We expect that we will require increasing amounts of working capital to finance our inventory levels in the United States. Except for Gosling's rums and the bourbon products (acquired in



October 2006), which are bottled in the United States, all of our products are imported from Europe. In the case of our wholly-owned brands, there is a three-to-four month production and shipping lead time between the time of order placement and the time the product is available for sale. This lead time has required us to ensure that we maintain sufficient inventories to properly service our customers.

We expect to experience a lengthening of the revenue collection cycle due to the need to extend payment terms as an incentive to encourage customers to make container-sized purchases of our products in which title passes to the customer at the shipping point in Ireland. A lengthening of the revenue collection cycle will require a significant amount of working capital.

***Cash Flows.***

The following table summarizes our primary sources and uses of cash during the periods presented (in thousands):

| | Six-months Ended September 30, 2006 | Six-months Ended September 30, 2005 |
|---|---|---|
| **Net cash provided by (used in):** | | |
| Operating activities | $ (13,472) | $ (8,310) |
| Investing activities | (230) | (164) |
| Financing activities | 25,819 | 11,326 |
| Effects of foreign currency translation | — | ($1) |
| Net increase in cash and cash equivalents | $ 12,117 | $ 2,851 |

*Operating Activities.* A substantial portion of our available cash has been used to fund our operating activities. In general, these cash funding requirements are based on operating losses, driven chiefly by our sizable investment in selling and marketing. With increases in our overall sales volumes, we have also utilized cash to fund our receivables and inventories. In general, these increases are only partially offset by increases in our accounts payable to our suppliers and accrued expenses. Our business has incurred significant losses since inception.

On average, the production cycle for our owned brands can take as long as four months from the time we obtain the distilled spirits and other materials needed to bottle and package our products to the time we receive products available for sale, which is impacted by the international nature of our business. With respect to Gosling's rums and Pallini liqueurs, we do not produce the finished product and, instead, receive the finished product directly from the owners of such brands. From the time we have products available for sale, an additional three-to-four months may be required before we sell our inventory and collect payment from our customers.

In the six-months ended September 30, 2006, net cash used in operating activities was $13.5 million, consisting primarily of losses from our operations of $8.3 million, an increase in accounts receivable of $2.8 million, increases in inventories and prepaid expenses of $2.0 million and $0.3 million, respectively, an increase in due to related parties, net, of $0.2 million, $0.5 million resulting from the effect of changes in foreign currency rates, and minority interest in the net loss of our 60%-owned subsidiary Gosling-Castle Partners Inc., of $0.7 million. These uses of cash were offset, in part, by non-cash charges for depreciation and amortization and share-based compensation expense of $0.5 million and $0.8 million, respectively.

*Investing Activities.* Net cash used in investing activities during the six-months ended September 30, 2006 was $0.2 million for the acquisition of property and equipment and intangible assets.

*Financing Activities.* Net cash provided by financing activities during the six-months ended September 30, 2006 was $25.8 million and consisted of $31.5 million from common stock issued in our initial public offering less $2.8 million in payments for the cost of stock issuance and the net repayment of notes payable in the amount of $2.7 million.



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As of November 10, 2006, our wholly owned subsidiary Castle Brands (USA) Corp. completed an offering to 11 persons of an aggregate of $5,340,000 of additional senior notes secured by accounts receivable and inventories of Castle Brands (USA), pursuant to the First Amended and Restated Indenture of Castle Brands (USA), dated as of June 1, 2004, and amended and restated as of August 15, 2005. The issuance was made pursuant to Regulation D and Regulation S under the Securities Act of 1933, as amended. The additional senior notes have substantially identical terms to the aggregate principal amount of $4,660,000 of senior notes previously issued under the indenture in 2004 and 2005 except that the additional senior notes were issued at a two percent discount to the stated principal amount. The additional senior notes bear interest at a rate of 9%, payable semi-annually on November 30th and May 31st, and mature on May 31, 2009. The additional senior notes will be treated as a single class with the previously issued senior notes.

As with the previously issued senior notes, we have guaranteed payment on the additional senior notes. We have also agreed to pay a one time fee equal to 1% of the aggregate principal amount of the additional senior notes, for an aggregate payment of $53,400, in the event that the notes remain outstanding at December 31, 2007.

The senior notes are subject to customary restrictive covenants. In addition, the consent of holders of a requisite majority of the aggregate principal amount of these notes is required for Castle Brands (USA) to take any of the following actions: merge or consolidate or sell all or substantially all of its assets other than with an entity formed in the United States or to a person or entity that assumes all of our obligations under the senior notes, engage in a transaction with an affiliate unless the transaction is on fair and reasonable terms, or change our jurisdiction of incorporation without giving 60 days prior notice.

We intend to use the proceeds from the sale of the additional senior notes to fund operating expenses and for general corporate purposes.

In addition, the additional senior notes were accompanied by warrants to purchase 40 shares of our common stock at $8.00 a share for every $1,000 principal amount of such notes, for an aggregate of 213,600 shares. The issuance was made pursuant to Regulation D and Regulation S under the Securities Act of 1933, as amended.

We believe that we will be able to fund our operations from the proceeds of our initial public offering, our projected cash flow from operations, and current cash and cash equivalents for the next twelve months. Beyond that, additional financing may be needed to fund working capital and other requirements. Changes in our operating plans, acquisitions or other additions of brands, lower than anticipated sales, increased expenses, or other events, including those described in our Annual Report on Form 10-K for the year ended March 31, 2006, under the caption ‘‘Risk Factors,’’ may require us to seek additional debt or equity financing on an accelerated basis. Financing may not be available on acceptable terms, or at all, and our failure to raise capital when needed could impact negatively our growth plans, financial condition and results of operations. Additional equity financing may be dilutive to the holders of our common stock, and debt financing, if available, may involve significant cash payment obligations or financial covenants and ratios that restrict our ability to operate our business.



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***Contractual obligations***

The following table sets forth our contractual commitments as of September 30, 2006 for each of the following twelve month periods:

**Payments due during the twelve month periods ending September 30,**

| | 2007 | 2008 | 2009 | 2010 | 2011 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| | | | | (in thousands) | | | |
| Long-term notes payable, including current portion and estimated interest | | | | | | | |
| Ulster Bank facilities | $ 936 | $ — | $ — | $ — | $ — | $ — | $ 936 |
| Gosling's export agreement | 625 | — | — | — | — | — | 625 |
| 9% senior notes | — | — | — | 4,660 | | | 4,660 |
| 6% convertible subordinated notes | — | — | — | 3,000 | 6,000 | — | 9,000 |
| Capital leases | 4 | 4 | 3 | | | | 11 |
| Operating leases | 297 | 136 | 2 | 1 | | — | 436 |
| Estimated interest | 965 | 965 | 611 | 360 | 15 | | 2,916 |
| Total | $ 2,827 | $ 1,105 | $ 616 | $ 8,021 | $ 6,015 | $ — | $ 18,584 |

**Critical Accounting Policies and Estimates**

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires us to make a number of 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. Such estimates and assumptions affect the reported amounts of sales and expenses during the reporting period. On an ongoing basis, we evaluate these estimates and assumptions based upon historical experience and various other factors and circumstances. We believe our estimates and assumptions are reasonable under the circumstances; however, actual results may differ from these estimates under different future conditions.

We believe that the estimates and assumptions discussed below are most important to the portrayal of our financial condition and results of operations in that they require our most difficult, subjective or complex judgments and form the basis for the accounting policies deemed to be most critical to our operations.

*Revenue Recognition*

We recognize revenue from product sales when the product is shipped to a customer (generally upon shipment to a distributor or to a control state entity), 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. We do not offer a right of return but will accept returns if we shipped the wrong product or wrong quantity.

*Accounts Receivable*

We record trade accounts receivable at net realizable value. This value includes an appropriate allowance for estimated uncollectible accounts to reflect any loss anticipated on the trade accounts receivable balances and charged to the provision for doubtful accounts. We calculate this allowance based on our history of write-offs, level of past due accounts based on contractual terms of the receivables and our relationships with, and economic status of, our customers.

*Inventory*

Our inventory, which consists of distilled spirits, packaging and finished goods, is valued at the lower of cost or market, using the weighted average cost method. We assess the valuation of our inventories and reduce the carrying value of those inventories that are obsolete or in excess of our



forecasted usage to their estimated realizable value. We estimate the net realizable value of such inventories based on analyses and assumptions including, but not limited to, historical usage, future demand and market requirements. Reduction to the carrying value of inventories is recorded in cost of goods sold.

*Goodwill and Other Intangible Assets*

Goodwill represents the excess of purchase price and related costs over the value assigned to the net tangible and identifiable intangible assets of businesses acquired. As of September 30, 2006, and March 31, 2006, goodwill and other intangible assets that arose from cumulative acquisitions were $25.3 million and $25.5 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.

We evaluate the recoverability of goodwill and indefinite lived intangible assets using a two-step impairment test approach at the reporting unit level. In the first step the fair value for the reporting unit is compared to its book value including goodwill. In the case that the fair value of the reporting unit is less than the book value, a second step is performed which compares the implied fair value of the reporting unit's goodwill to the book value of the goodwill. The fair value for the goodwill is determined based on the difference between the fair values of the reporting units and the net fair values of the identifiable assets and liabilities of such reporting units. If the fair value of the goodwill is less than the book value, the difference is recognized as an impairment.

SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to the estimated residual values and reviewed for impairment in accordance with SFAS No. 144, ''Accounting for the Impairment or Disposal of Long-Lived Assets.''

*Stock-Based Compensation*

Prior to April 1, 2006, we accounted for our employee stock option plan under the intrinsic value method in accordance with the provisions of Accounting Principles Board (''APB'') Opinion No. 25, ''Accounting for Stock Issued to Employees'' (''APB No. 25'') and related interpretations. Under APB No. 25, generally no compensation expense was recorded when the terms of the award are fixed and the exercise price of the employee stock option equals or exceeds the fair value of the underlying stock on the date of the grant. No stock based compensation expense has been recognized through March 31, 2006. Additionally, in periods prior to April 1, 2006, we followed the disclosure-only requirements of SFAS No. 123, ''Accounting for Stock-Based Compensation'' (''SFAS 123'') which allowed entities to continue to apply the provisions of APB No. 25 for transactions with employees and provide pro forma net income and pro forma earnings per share disclosures for employee stock grants made as if the fair value based method of accounting in SFAS 123 had been applied to these transactions.

Effective April 1, 2006, the Company adopted SFAS No. 123(R), ''Share-Based Payment'' (''SFAS 123(R)'') and related interpretations which superseded APB No. 25. SFAS 123(R) requires that all stock-based compensation be recognized as an expense in the financial statements and that such cost be measured at the fair value of the award. This statement was adopted using the modified prospective method, which requires us to recognize compensation expense on a prospective basis following adoption. Therefore, prior period financial statements have not been restated. Under this method, in addition to reflecting compensation expense for new share-based awards, expense is also recognized to reflect the remaining service period of awards that had been included in pro-forma disclosures in prior periods.

As a result of adopting SFAS 123(R) on April 1, 2006, our net loss for the three-months ended September 30, 2006 is $276,921 higher than if we had continued to account for share-based compensation under APB No. 25. Basic and diluted net loss per share for the three-months ended September 30, 2006 were increased by $0.02 per share as a result of adopting SFAS 123(R). For further information on the effect of our adoption of SFAS 123(R), see Note 1.R. to the condensed consolidated financial statements.



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*Fair Value of Investment.* SFAS No. 107, ''Disclosures About Fair Value of Financial Instruments,'' defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties and requires disclosure of the fair value of certain financial instruments. We believe that there is no material difference between the fair value and the reported amounts of financial instruments in the balance sheets due to the short-term maturity of these instruments, or with respect to the debt, as compared to the current borrowing rates available to us.

*Currency Translation.* The functional currencies for our foreign operations are the euro in Ireland, the British pound in the United Kingdom and the Canadian dollar in Canada. With respect to our consolidated financial statements, the translation from the applicable foreign currencies to U.S. dollars is performed for balance sheet accounts using exchange rates in effect at the balance sheet date and for revenue and expense accounts using a weighted average exchange rate during the period. The resulting translation adjustments are recorded as a component of other comprehensive income. Gains or losses resulting from foreign currency transactions are included in other income/expenses. See Item 3. Quantitative and Qualitative Disclosures about Market Risk for a description of risks associated with currency translation.

Where in this quarterly report we refer to amounts in euros, British pounds or Canadian dollars, we have for your convenience also in certain cases provided a translation of those amounts to U.S. dollars in parenthesis. Where the numbers refer to a specific balance sheet date account or financial statement period, account, we have used the exchange rate that was used to perform the translations in connection with the applicable financial statement. In all other instances, unless otherwise indicated, the translations have been made using the exchange rates as of September 30, 2006, each as calculated from the Interbank exchange rates as reported by Oanda.com. On September 30, 2006, the exchange rate of the euro, the British pound and the Canadian dollar in exchange for U.S. dollars were €1.00 = U.S. $1.2688 (equivalent to U.S. $1.00 = € 0.7882) for euros, £1.00 = U.S. $1.8726 (equivalent to U.S. $1.00 = £0.5340) for British Pounds, and CAN $1.00=U.S. $0.8979 (equivalent to U.S. $1.00 = CAN $1.1137), respectively.

These translations should not be construed as representations that the euro, British pound and Canadian dollar amounts actually represent U.S. dollar amounts or could be converted into U.S. dollars at the rates indicated.

**Recent Accounting Pronouncements**

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 108, ''Considering the Effects on Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements,'' (''SAB 108''). SAB 108 requires registrants to quantify errors using both the income statement method (i.e. iron curtain method) and the rollover method and requires adjustment if either method indicates a material error. If a correction in the current year relating to prior year errors is material to the current year, then the prior year financial information needs to be corrected. A correction to the prior year results that are not material to those years, would not require a ''restatement process'' where prior financials would be amended. SAB 108 is effective for fiscal years ending after November 15, 2006. The Company does not anticipate that SAB 108 will have a material effect on its financial position, results of operations or cash flows.

In September 2006, the 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 will be 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.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

As of September 30, 2006, we did not participate in any derivative financial instruments, or other financial or commodity instruments for which fair value disclosure would be required under SFAS No.



107, ''Disclosure About Fair Value of Financial Investments.'' We hold no investment securities that would require disclosure of market risk.

*Foreign Currency Risk*

International revenues from our non-U.S. operations accounted for approximately 31.5% and 32.5% of total revenues during the three month periods ended September 30, 2006 and 2005, respectively. International revenues from our non-U.S. operations also accounted for approximately 32.9% and 34.4% of total revenues during the six month periods ended September 30, 2006 and 2005, respectively. International revenues are generated from our foreign subsidiaries and are denominated in the local currency of each country. These subsidiaries incur most of their expenses in their local currency, and accordingly use the local currency as their functional currency.

Our international operations are subject to risks, including but not limited to differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility when compared to the United States. Accordingly, our future results could be materially adversely impacted by changes in these or other factors.

Foreign exchange rate fluctuations may adversely affect our consolidated financial position as well as our consolidated results of operations. Foreign exchange rate fluctuations may adversely impact our financial position as the assets and liabilities of our foreign operations are translated into U.S. dollars in preparing our consolidated balance sheet. Our exposure to foreign exchange rate fluctuations arises in part from balances in our intercompany accounts included on our subsidiary balance sheets. These intercompany accounts are denominated in the functional currency of the foreign subsidiaries. Additionally, foreign exchange rate fluctuations may significantly impact our consolidated results from operations as exchange rate fluctuations on transactions denominated in currencies other than the functional currencies of Castle Brands Inc. and its subsidiaries result in gains and losses that are reflected in our consolidated statement of income. The effect of foreign exchange rate fluctuations on our consolidated financial position for the six months ended September 30, 2006, was a net translation adjustment of approximately $0.2 million. This net translation adjustment is recognized within stockholders' equity through accumulated other comprehensive loss. We do not hedge against foreign currency risk.

From time to time we do participate in certain foreign exchange currency future contracts programs to limit our risk and the potential impact of currency fluctuations on our product costs. When placing a product order, we attempt to lock in its cost by buying forward contracts on euros coinciding with the projected payment dates for such purchases. Individual forward contracts rarely extend for more than six months or exceed €300,000 ($362,300). At September 30, 2006, there were no forward contracts outstanding.

*Interest Rate Risk*

Our exposure to market rate risk for changes in interest rates relates primarily to our short-term investment portfolio and issuance of debt. We do not use derivative financial instruments in our investment portfolio. We have a prescribed methodology whereby we invest excess cash in debt instruments of government agencies and high quality corporate issuers. The portfolio is managed by professional fund managers and our interest rate risk is minimal.

**Item 4. Controls and Procedures**

*Evaluation of disclosure controls and procedures*

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the ''Exchange Act'')) that are designed to ensure that information that would be required to be disclosed in Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including the Chief Executive Officer, President and Chief Operating Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding disclosure.



As of September 30, 2006, we carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer, President and Chief Operating Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer, President and Chief Operating Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

*Section 404 compliance project*

Beginning with our fiscal year ending March 31, 2009, Section 404 of the Sarbanes-Oxley Act of 2002 will require us to include management's report on our internal control over financial reporting in our Annual Report on Form 10-K. The internal control report must contain (1) a statement of management's responsibility for establishing and maintaining adequate internal control over our financial reporting, (2) a statement identifying the framework used by management to conduct the required evaluation of the effectiveness of our internal control over financial reporting, (3) management's assessment of the effectiveness of our internal control over financial reporting as of the end of our most recent fiscal year, including a statement as to whether or not our internal control over financial reporting is effective, and (4) a statement that our registered independent public accounting firm has issued an attestation report on management's assessment of our internal control over financial reporting.

In order to achieve compliance with Section 404 within the prescribed period, management has commenced a Section 404 compliance project under which management will engage outside consultants and adopt a detailed project work plan to assess the adequacy of our internal control over financial reporting, remediate any control deficiencies that may be identified, validate through testing that controls are functioning as documented and implement a continuous reporting and improvement process for internal control over financial reporting. During the six months ended September 30, 2006, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

We believe that neither we nor any of our subsidiaries is currently subject to litigation which, in the opinion of our management, is likely to have a material adverse effect on us. We may, however, become involved in litigation from time to time relating to claims arising in the ordinary course of our business. These claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

### Item 1A. Risk Factors

Not applicable.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

*Unregistered Sales of Equity Securities*

The Company did not sell any equity securities during the fiscal quarter ending September 30, 2006 which were not registered under the Securities Act of 1933, as amended.

*Use of proceeds from registered securities*

On April 6, 2006, we commenced our initial public offering of our common stock, $0.01 par value, pursuant to our Registration Statement on Form S-1 (File No. 333-128676), that was declared effective on April 5, 2006. We registered 3,500,000 shares of common stock, all of which were sold in the offering at a per share price of $9.00 for an aggregate offering price of $31.5 million. The underwriters in the offering were Oppenheimer & Co. Inc., ThinkEquity Partners LLC and Ladenburg Thalmann & Co. Inc.

The net proceeds received by us in the offering were $26,533,652, determined as follows:

| | |
|---|---|
| Aggregate offering proceeds to the Company | $ 31,500,000 |
| Underwriting discounts and commissions | 2,205,000 |
| Finders fee | — |
| Other fees and expenses | 2,761,348 |
| Total expenses | 4,966,348 |
| Net proceeds to the Company | $ 26,533,652 |

The Company has received all final invoices and adjustments incurred in connection with its initial public offering and has paid all balances in full.

No payments were made directly or indirectly to (i) any of our directors, officers or their associates, (ii) any person(s) owning 10% or more of any class of our equity securities or (iii) any of our affiliates, except as follows:

- repayment of $2,026,000 to an affiliate of one of our directors to repay all outstanding principal and interest under our February 2006 credit facility;
- payment of $105,246 for dividends accrued on preferred membership units of our predecessor company, Great Spirits Company, LLC to certain of our directors and executive officers; and
- payment of $354,130 in underwriting discount and commissions to Ladenburg Thalmann & Co. One of our directors is a principal stockholder and director of Ladenburg Thalmann.

We used $2,543,395 to repay indebtedness and the remaining net proceeds from the offering have been, and are expected to continue to be used by us to provide additional capital to support the growth of our business and for general corporate purposes.



***Dividend policy***

We do not intend to pay any cash dividends with respect to our common stock in the foreseeable future. We currently intend to retain any earnings for use in the operation of our business and to fund future growth. In addition, our ability to pay dividends is subject to the consent of the holders of our 6% convertible notes and we expect that any future credit facility will contain terms prohibiting or limiting the amount of dividends that may be declared or paid on our common stock. Any future determination to pay cash dividends will be at the discretion of our board of directors and will depend upon our financial condition, operating results, capital requirements and such other factors as the board of directors deems relevant.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Submission of Matters to a Vote of Security Holders**

(a) We held our Annual Meeting of Stockholders on September 20, 2006.

(b) Proxies for the meeting were solicited pursuant to Regulation 14 under the Exchange Act; there was no solicitation in opposition to our Board of Directors Nominating Committee's nominees listed in the Proxy Statement, and all such nominees were elected. Directors elected were Mark Andrews, John F. Beaudette, Robert J. Flanagan, Phillip Frost, M.D., Colm Leen, Richard C. Morrison, Frederick M. R. Smith and Kevin Tighe.

The results of the election of directors were as follows:

| | For | Against |
|---|---|---|
| Mark Andrews | 8,221,963 | 231,257 |
| John F. Beaudette | 7,305,872 | 1,147,368 |
| Robert J. Flanagan | 8,451,640 | 1,600 |
| Phillip Frost, M.D. | 6,766,582 | 1,686,658 |
| Colm Leen | 7,305,872 | 1,147,368 |
| Richard C. Morrison | 8,450,829 | 2,411 |
| Frederick M. R. Smith | 8,451,640 | 1,600 |
| Kevin Tighe | 8,451,640 | 1,600 |

(c) The appointment of Eisner LLP, independent registered public accounting firm, to audit our consolidated financial statements for the 2007 fiscal year was ratified by the following vote:

| | |
|---|---|
| For | 8,437,941 |
| Against | 8,299 |
| Abstain | 7,000 |

**Item 5. Other Information**

*Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant*

As of November 10, 2006, our wholly owned subsidiary Castle Brands (USA) Corp. completed an offering to 11 persons of an aggregate of $5,340,000 of additional senior notes secured by accounts receivable and inventories of Castle Brands (USA), pursuant to the First Amended and Restated Indenture of Castle Brands (USA), dated as of June 1, 2004, and amended and restated as of August 15, 2005. The issuance was made pursuant to Regulation D and Regulation S under the Securities Act of 1933, as amended. The additional senior notes have substantially identical terms to the aggregate principal amount of $4,660,000 of senior notes previously issued under the indenture in 2004 and 2005 except that the additional senior notes were issued at a two percent discount to the stated principal amount. The additional senior notes bear interest at a rate of 9%, payable semi-annually on November 30th and May 31st, and mature on May 31, 2009. The additional senior notes will be treated as a single class with the previously issued senior notes.



As with the previously issued senior notes, we have guaranteed payment on the additional senior notes. We have also agreed to pay a one time fee equal to 1% of the aggregate principal amount of the additional senior notes, for an aggregate payment of $53,400, in the event that the notes remain outstanding at December 31, 2007.

The senior notes are subject to customary restrictive covenants. In addition, the consent of holders of a requisite majority of the aggregate principal amount of these notes is required for Castle Brands (USA) to take any of the following actions: merge or consolidate or sell all or substantially all of its assets other than with an entity formed in the United States or to a person or entity that assumes all of our obligations under the senior notes, engage in a transaction with an affiliate unless the transaction is on fair and reasonable terms, or change our jurisdiction of incorporation without giving 60 days prior notice.

If we or Castle Brands (USA) were to default on the payment of principal or interest on the senior notes and the default continues for 20 business days, breach any representation, warranty or certification made in the senior note documents, default in the performance of the material obligations under the senior note documents, which default is unremedied for a period of 60 days after receipt of notice of such default, enter into any arrangement for the benefit of creditors or otherwise wind-up or dissolve, then the holders of the senior notes could declare all principal and interest to be immediately payable.

We intend to use the proceeds from the sale of the additional senior notes to fund operating expenses and for general corporate purposes.

*Unregistered Issuance of Equity Securities*

In conjunction with the sale and issuance of the additional senior notes described above, purchasers of additional senior notes were issued warrants to purchase 40 shares of our common stock at $8.00 a share for every $1,000 principal amount of such notes, for an aggregate of 213,600 shares. The warrants will expire on March 31, 2012. The issuance was made pursuant to Regulation D and Regulation S under the Securities Act of 1933, as amended (the ‘‘Securities Act’’).

For the warrants offered and sold in the United States, we made the determination that the warrants were offered and sold in reliance on Regulation D based on the representations of each investor for whom we relied upon such exemption, which included, in pertinent part, that each investor is an ‘‘accredited investor’’ within the meaning of Rule 501 of Regulation D promulgated under the Securities Act, and that each investor was acquiring the warrants for investment purposes for his, her or its own account and not as nominee or agent, and not with a view to the resale or distribution, and that each investor understood that such securities may not be sold or otherwise disposed of without registration under the Securities Act or an applicable exemption therefrom.

For the warrants offered and sold outside of the United States, we made the determination that the warrants were offered and sold in reliance on Regulation S based on the representations of each investor for whom we relied upon such exemption, which included, in pertinent part, that each investor is not a ‘‘U.S. Person’’ and was located outside of the United States, in each case within the meaning of Regulation S promulgated under the Securities Act, and that each investor was acquiring the warrants for investment purposes for his, her or its own account and not as nominee or agent, and not with a view to the resale or distribution, and that each investor understood that such securities may not be sold or otherwise disposed of without registration under the Securities Act or an applicable exemption therefrom.

**Item 6. Exhibits**

| Exhibit Number | Description |
|---|---|
| 10.63 | Stock Purchase Agreement, dated as of October 12, 2006, among Chester F. Zoeller III, Brittany Lynn Zoeller Carlson and Beth Allison Zoeller Willis and the Company. (incorporated herein by reference to Exhibit 10.1 to our Current Report on Form 8-K (File No. 001-32849) filed with the Securities and Exchange Commission on October 16, 2006). |
| 10.64 | 9% Senior Note of Castle Brands (USA) Corp. |
| 10.65 | Form of Warrant |
| 31.1 | Certification Pursuant to Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification Pursuant to Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**CASTLE BRANDS INC.**

By: /s/ Keith A. Bellinger
Keith A. Bellinger
President and Chief Operating Officer
(Duly Authorized Officer and Principal Financial Officer)

November 14, 2006

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Exhibit 10.64

**CASTLE BRANDS (USA) CORP.**

No. 053109-002

**9% Senior Secured Note, Series 2004, due May 31, 2009**
**Non-Negotiable**

**$5,340,000** November 10, 2006

THE SECURITY EVIDENCED HEREBY AND BENEFICIAL INTERESTS HEREIN WERE ISSUED IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER SECTION 5 OF THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE SECURITIES ACT ), AND THE SECURITY EVIDENCED HEREBY AND BENEFICIAL INTERESTS HEREIN MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED IN THE ABSENCE OF SUCH REGISTRATION OR AN APPLICABLE EXEMPTION THEREFROM. THE OWNER OF THIS NOTE AND ANY BENEFICIAL INTERESTS HEREIN ARE HEREBY NOTIFIED THAT THE ISSUER HAS NOT REGISTERED THIS SECURITY UNDER THE SECURITIES ACT OR ANY APPLICABLE STATE SECURITIES LAWS. THE OWNER OF THIS NOTE AND ANY BENEFICIAL INTEREST HEREIN AGREES FOR THE BENEFIT OF THE ISSUER THAT SUCH SECURITY MAY BE RESOLD, PLEDGED OR OTHERWISE TRANSFERRED, ONLY (1) IN ACCORDANCE WITH AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT, OR (2) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT AND, IN EACH CASE, IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER APPLICABLE JURISDICTION.

Castle Brands (USA) Corp., a Delaware corporation (the *Issuer*), for value received, hereby promises to pay to The Bank of New York Trust Company, National Association (successor trustee to JPMorgan Chase Bank, National Association), its successors and assigns (the *Trustee*), for the benefit of registered owners of beneficial interests in this Note under Amended and Restated Trust Indenture dated as of August 15, 2005 (the *Indenture*), the principal sum of **Five Million Three Hundred Forty Thousand Dollars ($5,340,000.00)** on May 31, 2009 (the *Maturity Date*), and to pay interest accrued (computed on the basis of a 360-day year of twelve 30-day months) on the unpaid principal balance from the date of this Note at the rate of 9.00 % per annum, semi-annually, on the 31st day of each May and the 30th day of November of each year, and on the Maturity Date, with the first payment of interest being due on November 30, 2006. The Issuer further promises to pay on demand interest on any overdue principal, including any overdue prepayment of principal, and or overdue installment of interest, at a rate of interest per annum equal to the Default Rate as defined in the Indenture; provided that interest on this Note shall in no event exceed the maximum rate permitted by applicable law, and this Note is expressly made subject to the interest rate limitation provisions of Section 13.5 of the Indenture.

This Note is secured as set forth in the Indenture and in the Security Documents and is entitled to the benefits of the Parent Guaranty (as defined in the Indenture).

This Note is transferable only by surrender thereof to a successor Trustee and Depository under the Indenture, duly endorsed or accompanied by a written instrument of transfer duly executed by the registered holder of this Note or its attorney duly authorized in writing.

Following any partial prepayment of this Note, this Note shall be made available to the Trustee for notation hereon of the amount of principal so prepaid. In case the entire principal amount on this Note is prepaid or paid, this Note shall be marked paid in full by the Trustee, cancelled and returned to the Issuer. This Note may be prepaid in whole or in part at any time without penalty.

In any case where the date of maturity of any interest or principal owed with respect to this Note or the date fixed for any prepayment (in whole or in part) of this Note will not be a Business Day, then payment of such interest, or principal need not be made on such date but may be made on the next succeeding Business Day with the same force and effect as if made on the date of maturity or the date fixed for such prepayment.

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Under certain circumstances, as specified in the Indenture, the entire principal amount of this Note may be declared due and payable in the manner and with the effect provided in the Indenture.

This Note and the Indenture shall be governed by, and construed in accordance with, the laws of the state of New York other than conflict of law rules thereof that would require the application of the laws of a jurisdiction other than such state.

Dated as of November 10, 2006

| | |
|---|---|
| ATTEST: | **CASTLE BRANDS (USA) CORP.** |
| /s/ Seth Weinberg | By: /s/ Mark Andrews |
| Secretary: Seth Weinberg | Name: Mark Andrews |

Title: Chief Executive Officer and Chairman

This is one of the Notes referred to in the Indenture referred to herein and has been duly authenticated by the Trustee as witnessed below.

**The BANK of NEW YORK TRUST COMPANY**, **National Association**
as Trustee

Date of authentication: November 13, 2006

By: /s/ Maurie Cowen
Name: Maurie Cowen
Title: Vice President and Trust Officer

**Exhibit 10.65**

**FORM OF WARRANT – NOT A VALID CERTIFICATE**

NEITHER THIS WARRANT AGREEMENT NOR THE SECURITIES REPRESENTED BY THIS WARRANT AGREEMENT HAVE BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR THE SECURITIES LAWS OF ANY STATE. THIS WARRANT AGREEMENT AND, UPON ACQUISITION, THE SECURITIES REPRESENTED HEREBY HAVE BEEN ACQUIRED FOR INVESTMENT AND MAY NOT BE SOLD, OFFERED FOR SALE OR TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND ANY APPLICABLE STATE SECURITIES LAWS OR AN OPINION OF COUNSEL IN FORM AND FROM COUNSEL REASONABLY ACCEPTABLE TO CASTLE BRANDS THAT THE TRANSACTION SHALL NOT RESULT IN A VIOLATION OF STATE OR FEDERAL SECURITIES LAWS.

**WARRANT AGREEMENT**

| | | |
|---|---|---|
| DATE: | November 10, 2006 | |
| PARTIES: | [Name]<br>[Address] | (''Investor'') |
| | Castle Brands Inc.<br>570 Lexington Avenue, 29th Floor<br>New York, New York 10022 | (''Castle Brands'') |

**RECITALS:**

1. Castle Brands owns all the capital stock of its U.S. subsidiary, Castle Brands (USA) Corp., a Delaware corporation (the ''U.S. Subsidiary'').

2. The U.S. Subsidiary is offering for sale at par up to a maximum $5,340,000 principal amount 9% Senior Secured Notes, Series 2006 due May 31, 2009 (the ''Notes'') in a private placement transaction exempt under federal and state securities laws.

3. The board of directors of Castle Brands believes that it is in the best interests of Castle Brands and its U.S. Subsidiary to enable the sale of the Notes by offering to each Note purchaser (''Investor'') the rights to purchase (such right is hereinafter referred to as the ''Warrant Rights'') under this Warrant Agreement forty (40) shares of Castle Brands common stock, $.01 par value per share (''Common Stock''), for each $1,000 principal amount of Notes subscribed to by Investor and purchased from the U.S. Subsidiary.

4. The Notes and Warrant Rights are offered in tandem (together, the ''Securities'') to a limited number of accredited investors in compliance with applicable exemptions from state and federal securities laws.

5. Following the purchase by Investor, the Warrant Rights and Notes will be separate securities, such that, among other things, (i) each of the Securities will be issued by a separate entity pursuant to separate documentation and will constitute the primary obligation of the issuing entity, (ii) each of the Securities will be transferable without requiring transfer of the other Security, and (iii) the Warrant Agreement and Warrant Rights will survive the payment of the Notes.

NOW, THEREFORE, in consideration of Investor's purchase of the Notes and the benefit therefrom that will inure to Castle Brands, and the mutual agreements contained herein, the parties agree as follows:

**Section 1 GRANT AND ACCEPTANCE OF WARRANT AGREEMENT**

Castle Brands grants and delivers this Warrant Agreement to Investor entitling it and its permitted transferees under Section 4.3 below, subject to the terms and conditions set forth in this Warrant

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Agreement, to purchase from the date of this Warrant Agreement to March 31, 2012 (the ''Expiration Date''), ( ) shares of Castle Brands Common Stock at the purchase price of U.S. $8.00 per share (subject to adjustment as hereafter provided), upon presentation of this Warrant Agreement and payment of the purchase price in cash, certified check or bank draft payable to Castle Brands or other form of payment acceptable to Castle Brands at the office of Castle Brands at the address indicated above. Investor accepts and agrees to the terms and conditions of this Warrant Agreement.

**Section 2 DURATION AND EXERCISE OF WARRANT AGREEMENT**

2.1 Term. This Warrant Agreement shall become void unless it is exercised and payment of the purchase price is made prior to the Expiration Date.

2.2 Exercise of Warrant Agreement. This Warrant Agreement may be exercised during its exercise period by Investor, and at its option, as to the whole at any time or in part from time to time. If this Warrant Agreement is exercised for less than the maximum number of shares of Common Stock purchasable upon the exercise hereof, Castle Brands shall issue to Investor a new warrant agreement of like tenor and date representing the right to purchase a number of shares of Common Stock equal to the difference between the number of shares purchasable upon full exercise of this Warrant Agreement and the number of shares that were purchased upon the exercise of this Warrant Agreement. To be exercised, this Warrant Agreement must be surrendered by Investor for cancellation at the office of Castle Brands accompanied with written instructions as to the number of shares to be purchased and the payment of the purchase price.

2.3 Investment Interest. Unless the shares to be acquired hereunder have been registered under applicable securities laws and a representation for investment intent is not needed to comply with the securities laws, if required by Castle Brands at the time of any exercise of this Warrant Agreement, as a condition to such exercise, Investor shall enter into an agreement with Castle Brands in form reasonably satisfactory to counsel for Castle Brands by which Investor (1) shall represent that it is an ‘‘accredited investor’’ as defined by Rule 501 of Regulation D promulgated under the Securities Act of 1933, as amended (the ‘‘Securities Act’’), and the shares are being acquired for Investor's own account for investment and not with a view to, or for sale in connection with, any resale or distribution of such shares, and (2) shall agree that, if Investor should decide to sell, transfer, or otherwise dispose of any of such shares, Investor may do so only in accordance with this Warrant Agreement and applicable securities laws.

2.4 Conversion Notice. The Warrant Agreement may be exercised by Investor, at any time or from time to time, prior to the Expiration Date, on any business day by delivering a written notice of the exercise of this Warrant Agreement (the ‘‘Conversion Notice’’) to Castle Brands at its principal office specifying (i) the total number of shares Investor will purchase pursuant to such conversion and (ii) a place and date not less than five nor more than 30 days from the date of the Conversion Notice for the closing of such purchase.

**Section 3 COVENANTS OF CASTLE BRANDS**

3.1 Reservation of Stock. Castle Brands covenants that, while this Warrant Agreement is exercisable, it shall reserve a sufficient number of shares to provide for the delivery of shares pursuant to the exercise of this Warrant Agreement.

3.2 Validly Issued Stock. Castle Brands covenants and agrees that all shares of Common Stock that may be issued upon the exercise of this Warrant Agreement shall, upon issuance, be duly and validly issued, fully paid and nonassessable, and free from all taxes, liens and charges with respect to the purchase and the issuance of the shares.

3.3 Due Authorization. Castle Brands covenants that all acts and things necessary have been done and performed to make this Warrant Agreement, when executed on behalf of Castle Brands, the valid, binding and legal obligation of Castle Brands and to authorize the execution and delivery of this Warrant Agreement, and Castle Brands covenants that all acts and things necessary will have been done and performed prior to the issuance of the shares of Common Stock purchasable under this Warrant Agreement to make such issuance a duly authorized, valid and legal act of Castle Brands.



**Section 4 RESTRICTIONS ON TRANSFERABILITY**

4.1 Transfer Restrictions. Unless and until registered or an exemption is available from such registration, this Warrant Agreement, the Warrant Rights, the shares of Common Stock purchased upon exercise of this Warrant Agreement (‘‘Purchased Shares’’) and purchasable upon exercise of this Warrant Agreement (‘‘Underlying Shares’’) shall not be sold, assigned, transferred or pledged except upon the conditions specified in Section 4 of this Warrant Agreement, which conditions are intended to ensure compliance with the provisions of the applicable federal and state securities laws.

4.2 Securities Compliance. Investor represents that it is an ‘‘accredited investor’’ as defined by Rule 501 of Regulation D promulgated under the Securities Act and acquiring the Warrant Rights and the Underlying Shares for its own account for investment, and not with the view to, or for resale in connection with, any distribution thereof. Investor understands that the Warrant Rights and the Underlying Shares have not been registered under the Securities Act or any applicable state securities laws by reason of specific exemptions from the registration provisions of those securities laws, the availability of which depends upon, among other things, the bona fide nature of the investment intent and the accuracy of Investor's representation herein. Investor acknowledges that this Warrant Agreement, the Purchased Shares and the Underlying Shares must be held indefinitely, unless subsequently registered under the Securities Act or unless an exemption from registration is available.

4.3 Transferees Bound By This Warrant Agreement. Notwithstanding anything else to the contrary stated in this Warrant Agreement, no transfer of the Warrant Agreement or the Warrant Rights shall be made unless the transferee executes a counterpart copy of this Warrant Agreement, as amended, pursuant to which the transferee agrees to be bound by the provisions of this Warrant Agreement, as amended; provided, however, that this Section 4.3 shall not apply to the extent that either the Underlying Shares or the Purchased Shares are registered under applicable securities laws.

4.4 Notice of Proposed Transfers. Prior to any proposed sale, assignment, transfer or pledge of this Warrant Agreement, Underlying Shares or Purchased Shares, unless there is in effect a registration statement under the Securities Act, covering the proposed transfer, Investor shall give written notice to Castle Brands of its intention to effect such transfer, sale, assignment or pledge. Each such notice shall describe the manner and circumstances of the proposed transfer, sale, assignment or pledge in sufficient detail and, if Castle Brands reasonably so requests, shall be accompanied at Investor's expense by either (i) a written opinion of legal counsel in form and from counsel reasonably acceptable to Castle Brands which states that the proposed transfer of this Warrant Agreement, Underlying Shares or Purchased Shares may be effected without registration under the Securities Act or (ii) a ‘‘no action’’ letter from the Securities and Exchange Commission (the ‘‘Commission’’) to the effect that the transfer of such securities without registration will not result in a recommendation by the staff of the Commission that action be taken with respect thereto, whereupon the holder of such Warrant Agreement, Underlying Shares or Purchased Shares shall be entitled to transfer such Warrant Agreement, Underlying Shares or Purchased Shares in accordance with the terms of the notice delivered by Investor to Castle Brands. Each certificate evidencing the Purchased Shares transferred as above provided shall bear the appropriate restrictive legends set forth in this Warrant Agreement, except that such certificate shall not bear such restrictive legends if, in the opinion of counsel for Castle Brands, such legends are not required in order to establish compliance with any provisions of the Securities Act.

4.5 Restrictive Legends. Each certificate representing the Purchased Shares and any other securities issued in respect of the Purchased Shares upon any stock split, stock dividend, recapitalization, merger, consolidation or similar event unless the same are registered prior to exercise of this Warrant Agreement, shall be stamped or otherwise imprinted with a legend in substantially the following form:

> THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR THE SECURITIES LAWS OF ANY STATE. THE SECURITIES HAVE BEEN ACQUIRED FOR INVESTMENT AND MAY NOT BE SOLD, OFFERED FOR SALE OR TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND



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> ANY APPLICABLE STATE SECURITIES LAWS OR AN OPINION OF COUNSEL IN FORM AND FROM COUNSEL REASONABLY ACCEPTABLE TO CASTLE BRANDS THAT THE TRANSACTION SHALL NOT RESULT IN A VIOLATION OF STATE OR FEDERAL SECURITIES LAWS.

Investor consents to Castle Brands making a notation on its records and giving instructions to any transfer agent of the Purchased Shares in order to implement the restrictions on transfer established in this Warrant Agreement.

4.6 Modification of this Section. If a registration statement under the Securities Act is hereafter filed with respect to this Warrant Agreement, Purchased Shares or the Underlying Shares, the provisions in this Warrant Agreement that would otherwise be required by this Section 4 shall be appropriately modified or eliminated.

4.7 Otherwise Transferable. Subject to the transfer conditions set forth in this Section 4, this Warrant Agreement and the Warrant Rights, the Underlying Shares or Purchased Shares are transferable, in whole or in part, without charge to Investor, upon surrender of this Warrant at the principal office of Castle Brands.

**Section 5 ANTI-DILUTION ADJUSTMENTS**

5.1 Adjustment of Exercise Price and Number of Shares. In order to prevent dilution of the Warrant Rights granted under this Warrant Agreement, the purchase price of each Underlying Share (the ‘‘Exercise Price’’) shall be subject to adjustment from time to time as provided in this Section 5, and the number of shares obtainable upon exercise of this Warrant Agreement shall be subject to adjustment from time to time as provided in this Section 5.

5.2 Subdivision or Combination of Shares. If Castle Brands at any time subdivides (by any stock split or recapitalization) one or more classes of its outstanding shares of its Common Stock into a greater number of shares, the Exercise Price in effect immediately prior to such subdivision shall be proportionately reduced and the number of Underlying Shares obtainable upon exercise of this Warrant shall be proportionately increased. If Castle Brands at any time combines (by reverse stock split or otherwise) its outstanding shares of its Common Stock into a smaller number of shares, the Exercise Price in effect immediately prior to such combination shall be proportionately increased and the number of Underlying Shares obtainable upon exercise of this Warrant shall be proportionately decreased.

5.3 Reorganization, Reclassification, Consolidation, Merger or Sale. Any recapitalization, reorganization, reclassification, consolidation, merger, sale of all or substantially all of Castle Brands's assets or other transaction, which in each case is effected in such a way that the holders of Common Stock are entitled to receive (either directly or upon subsequent liquidation) stock, securities or assets with respect to or in exchange for shares of Common Stock is referred to herein as an *‘‘Organic Change.’’* Prior to the consummation of any Organic Change, Castle Brands shall make appropriate provision (in form and substance satisfactory to Investor) to insure that Investor shall thereafter have the right, in lieu of or in addition to (as the case may be) the Underlying Shares immediately theretofore acquirable upon the exercise of this Warrant Agreement, to receive such shares of stock, securities or assets as may be issued or payable with respect to or in exchange for the number of shares of Common Stock immediately theretofore acquirable upon exercise of this Warrant Agreement had such Organic Change not taken place. In any such case, Castle Brands shall make appropriate provision (in form and substance satisfactory to Investor) with respect to Investor's rights and interests to insure that the provisions of this Section 5 shall thereafter be applicable to this Warrant Agreement (including, in the case of any such consolidation, merger or sale in which the successor entity or purchasing entity is other than Castle Brands, an immediate adjustment of the Exercise Price to the value for the shares reflected by the terms of such consolidation, merger or sale, and a corresponding immediate adjustment in the number of Underlying Shares acquirable and receivable upon exercise of this Warrant Agreement, if the value so reflected is less than the Exercise Price in effect immediately prior to such consolidation, merger or sale).

5.4 Notices.

(i) Immediately upon any adjustment of the Exercise Price, Castle Brands shall give written notice thereof to Investor, setting forth in reasonable detail and certifying the calculation of such adjustment.



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(ii) Castle Brands shall give written notice to Investor at least 20 days prior to the date on which Castle Brands closes its books or takes a record (A) with respect to any dividend or distribution upon the shares of Common Stock, (B) with respect to any pro rata subscription offer to holders of shares of Common Stock or (C) for determining rights to vote with respect to any Organic Change, dissolution or liquidation.

(iii) Castle Brands shall also give written notice to Investor at least 20 days prior to the date on which any Organic Change, dissolution or liquidation shall take place.

**Section 6 LIMITED REGISTRATION RIGHTS**

6.1 Limited Registration Rights.

6.1.1 None of this Warrant Agreement, the Purchased Shares or the Underlying Shares has been registered under the securities laws of any jurisdiction.

6.1.2 Except as specifically provided for in Section 6.1 of this Warrant Agreement, Castle Brands is not obligated to register the Warrant Agreement, the Purchased Shares or the Underlying Shares.

6.1.3 If Castle Brands shall determine to register any of its shares of Stock, either for its own account or the account of a holder (as hereinafter defined) other than (x) a registration relating solely to employee benefit plans or (y) a registration relating solely to a Commission Rule 145 transaction, Castle Brands will:

(i) promptly give to Investor written notice thereof; and

(ii) include in such registration (and any related qualification under blue sky laws or other compliance), and in any underwriting involved therein, all Purchased Shares and Underlying Shares (not previously disposed of) specified in a written request or requests made within 30 days after receipt of such written notice from Castle Brands by any Investor (‘‘Registrable Securities’’).

6.1.4 Underwriting. If the registration of which Castle Brands gives notice is for a registered public offering involving an underwriting, Castle Brands shall so advise Investor as a part of the written notice given pursuant to this Section 6.1. In such event, the right of Investor to registration pursuant to this Section 6.1 shall be conditioned upon Investor's participation in such underwriting and the inclusion of Registrable Securities in the underwriting to the extent provided herein. All holders proposing to distribute their securities through such underwriting shall (together with Castle Brands and the Investors distributing their shares of Registrable Securities through such underwriting) enter into an underwriting agreement in customary form with the managing underwriter selected for such underwriting by Castle Brands and may, at their option, require that any or all of the representations and warranties by, and the other agreements on the part of, Castle Brands to and for the benefit of such underwriters also be made to and for their benefit and that any or all of the conditions precedent to the obligations of such underwriters under such underwriting agreement also be conditions precedent to their obligations. No Investor other than an Investor who, together with its affiliates (within the meaning of Rule 12b-2 under the Securities and Exchange Act of 1934, as amended (the ‘‘Exchange Act’’), owns at least a majority of the outstanding capital stock of Castle Brands (on an as-converted basis, if applicable) shall be required to make any representations or warranties to or agreements with Castle Brands or the underwriters other than representations, warranties or agreements regarding such Investor and its ownership of the shares of capital stock being registered on its behalf and such Investor's intended method of distribution and any other representation required by law. Notwithstanding any other provision of this Section 6.1.4, if the managing underwriter determines that marketing factors require a limitation of the number of shares of Registrable Securities to be underwritten, the managing underwriter may limit the number of Registrable Securities to be included in the registration and underwriting (up to the exclusion of all Registrable Securities), on a *pro rata* basis based on the total number of shares of capital stock of Castle Brands (including Registrable Securities) (on an as-converted basis) requested to be included in such registration. To facilitate the allocation of capital stock in accordance with the above provisions, Castle Brands or the underwriters may round the number of shares of Registrable Securities allocated to the Investor to the



nearest 10 shares of Registrable Securities. If the Investor disapproves of the terms of any such underwriting, it may elect to withdraw therefrom by written notice to Castle Brands and the managing underwriter.

6.1.5 Right to Terminate Registration. Castle Brands shall have the right to terminate or withdraw any registration initiated by it under this Section 6.1 prior to the effectiveness of such registration, whether or not the Investor has elected to include his Registrable Securities in such registration.

6.1.6 Registrable Securities. If at any time Registrable Securities are to be included in a registration pursuant to this Section 6.1, the securities to be registered shall be the Purchased Shares or Underlying Shares.

6.2 Expenses of Registration.

All registration and other related expenses incurred in connection with any registration pursuant to this Section 6, and the reasonable cost of one special legal counsel to represent all Investors, shall be borne by Castle Brands, except for Investor's share of underwriter's fees, if any.

6.3 Indemnification.

6.3.1 Indemnification by Castle Brands. To the extent permitted by law, Castle Brands will indemnify Investor within the meaning of the Securities Act with respect to which registration, qualification or compliance has been effected pursuant to this Section 6 against losses, claims, damages, liabilities, investigations, actions, proceedings and expenses caused by any untrue statement or alleged untrue statement of a material fact contained in any registration statement, prospectus or preliminary or summary prospectus, or any amendment thereof or supplement thereto, or any omission or alleged omission of a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading, and Castle Brands will reimburse Investor for any legal and other expenses reasonably incurred by Investor in connection with investigating or defending any such loss, claim, liability, investigation, action or proceeding except insofar as the same was made in reliance upon and in conformity with written information furnished to Castle Brands by an instrument duly executed by Investor expressly stated for use therein (''Investor's Information'') or such liability arises out of or is based on willful misconduct of Investor.

6.3.2 Indemnification by Investor. To the extent permitted by law, in connection with each registration relating to the disposition of the Purchased Shares or Underlying Shares by Investor pursuant to Section 6, Investor will indemnify Castle Brands, each of its directors, officers, agents, and any person who controls Castle Brands (within the meaning of the Securities Act) against all losses, claims, damages, liabilities, investigations, actions, proceedings and expenses described in Section 6.1 above, but only with respect to untrue statements or omissions made in the registration statement, any preliminary or summary prospectus or the prospectus or any amendment or supplement thereto in reliance upon and in conformity with Investor's Information; provided, however, that the liability of Investor for indemnification under this Section 6.3.2 shall not exceed the gross proceeds from the offering received by Investor, unless such liability arises out of or is based on the bad faith or willful misconduct of Investor.

6.3.3 Claims for Indemnification. Each party entitled to indemnification under this Section 6 (the ''Indemnified Party'') shall give written notice to the party required to provide indemnification (the ''Indemnifying Party'') promptly after such Indemnified Party has actual knowledge of any claim as to which indemnity may be sought and shall unless in the Indemnified Party's reasonable judgment a conflict of interest may exist between the Indemnified Party and the Indemnifying Party in respect of such claim, permit the Indemnifying Party to assume the defense of any such claim or any litigation resulting therefrom, provided that counsel for the Indemnifying Party, who shall conduct the defense of such claim or litigation, shall be approved by the Indemnified Party (which approval shall not unreasonably be withheld), and the Indemnified Party may participate in such defense at such party's expense, and provided further that the failure of any Indemnified Party to give notice as provided herein shall not relieve the Indemnifying Party of its obligations under this Section 6 except to the extent that the failure to give such notice is materially prejudicial to an Indemnifying Party's ability to defend such action. No Indemnifying Party, in the defense of any such claim or litigation, shall, except with the consent of each



Indemnified Party, consent to entry of any judgment or enter into any settlement that does not include as an unconditional term thereof the giving by the claimant or plaintiff to such Indemnified Party of a release from all liability in respect to such claim or litigation.

6.3.4 Survival of Indemnification. The indemnification provided for under this Section 6 will remain in full force and effect regardless of any investigation made by or on behalf of the Indemnified Party. The obligations of Castle Brands and Investor under this Section 6 shall survive the completion of any offering of registrable securities in a registration statement pursuant to this Warrant Agreement. The parties agree to make such provisions for contribution as are reasonably requested by the other party hereto, in the event indemnification is unavailable for any reason.

6.4 Information by Investor; Copies of Prospectus. Investor shall furnish to Castle Brands such information regarding itself, the Registrable Securities held by it and the distribution proposed by it as Castle Brands may reasonably request in writing and as shall be required in connection with any registration, qualification or compliance referred to in this Section 6. In connection with any such registration, Castle Brands shall furnish to Investor the registration statement and each amendment and supplement thereto and such other documents as Investor may reasonably request, and such numbers of copies as it may reasonably request, in order to facilitate the disposition of registrable securities owned by it, of any prospectus or preliminary or summary prospectus prepared in conformity with the Securities Act.

6.5 Obligations of Castle Brands. Whenever required under this Section 6 to effect the registration of any Purchased Shares or Underlying Shares pursuant to Section 6.1, Castle Brands shall, as soon as practicable:

6.5.1 Prepare and file with the Commission a registration statement with respect to such securities and use its reasonable efforts to cause such registration statement to become effective and remain effective for at least 120 days.

6.5.2 Prepare and file with the Commission such amendments and supplements to such registration statement and the prospectus used in connection with such registration statement as may be necessary to keep such registration statement effective for at least 120 days, and to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by such registration statement.

6.5.3 Use its reasonable efforts to register and qualify the securities covered by such registration statement under such other securities or blue sky laws of such jurisdictions where an exemption is not available as shall be reasonably requested by Investor, to keep such registration or qualification in effect for so long as such registration statement remains in effect, provided that Castle Brands shall not be required in connection therewith or as a condition thereto to file a general consent to service of process in any such states or jurisdictions.

6.5.4 Notify Investor at any time when a prospectus relating thereto is required to be delivered under the Securities Act upon discovery that or upon the happening of any event as a result of which the prospectus included in such registration statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances then existing, and at the reasonable request of Investor furnish to Investor a reasonable number of copies of a supplement to or an amendment of such prospectus as may be necessary so that, as thereafter delivered to the purchasers of such securities, such prospectus shall not include an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances in which they were made.

6.5.5 Furnish, at the request of Investor, on the date that such securities are delivered to the underwriters for sale in connection with a registration pursuant to this Warrant Agreement, if such securities are being sold through underwriters, or, if such securities are not being sold through underwriters, on the date that the registration statement with respect to such securities becomes effective, (i) an opinion dated such date of the counsel representing Castle Brands for the purposes of such registration, in form and substance as is customarily given to underwriters in an underwritten public



offering, addressed to the underwriters, if any, and to Investor and (ii) a letter dated such date from the independent certified public accountants of Castle Brands in form and substance as is customarily given to underwriters in an underwritten public offering, addressed to the underwriters, if any, and to Investor. Any opinion or letter given shall be subject to all of the qualifications, exceptions and conditions appropriate to the then existing circumstances.

6.5.6 Use its reasonable efforts to cause all registered shares to be listed on each securities exchange on which Castle Brands common stock is then listed.

6.6 Removal of Legend. After registration of the Purchased Shares and upon the reasonable request of Investor and at Castle Brands' expense, Castle Brands shall take such reasonable actions as are necessary to remove the legends and restrictions on transfer established in this Warrant Agreement.

6.7 Certain Limitations. The Investor shall not have the right to participate in a registration under this Section 6 if the Investor receives a written opinion of counsel for Castle Brands, in substance and authorship acceptable to Investor, together with a confirming opinion of counsel selected by Investor, that Investor may make such transfer of all Registrable Securities (if applicable) in a public sale which will be in compliance with all applicable securities laws concerning transfer of non-registered securities. If the right to transfer Registrable

Securities publicly is not available to the Investor as described in the preceding sentence, Investor will have the right to participate in a registration pursuant to the terms and conditions of this Section 6.

6.8 Termination of Rights. The rights of the Investor to cause Castle Brands to register securities under Section 6 shall terminate on April 6, 2008.

**Section 7 TAX WITHHOLDING**

If, in connection with the exercise of this Warrant Agreement or any sale, transfer or other disposition of any of the Purchased Shares acquired upon exercise of this Warrant Agreement, Castle Brands is required by applicable federal, state or local law to withhold any amount on account of employment, income or similar taxes, Investor agrees to pay to Castle Brands upon request the amount required to be withheld.

**Section 8 MISCELLANEOUS**

8.1 Transfer; Successors and Assigns. Except as the transferability of rights is expressly limited herein, the terms and conditions of this Warrant Agreement shall inure to the benefit of and be binding upon the respective successors and assigns of the parties. Nothing in this Warrant Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations or liabilities under or by reason of this Warrant Agreement, except as expressly provided in this Warrant Agreement.

8.2 Titles and Subtitles. The titles and subtitles used in this Warrant Agreement are used for convenience only and are not to be considered in construing or interpreting this Warrant Agreement.

8.3 Notices. All notices, requests, demands or other communications required or permitted to be given under this Warrant Agreement shall be in writing, delivered to or sent by fax, or postage prepaid certified mail, addressed (a) if to Investor, at such address as such Investor shall have furnished to Castle Brands in writing, or (b) if to Castle Brands, at such address as Castle Brands shall have furnished in writing to Investor to the attention of the President. Any notice or other communication shall be deemed to be given at the expiration of the fifth (5th) day after the date of deposit in the United States mail. The addresses to which notices or other communications shall be mailed may be changed from time to time by giving written notice to the other party as provided in this Section 8.3.

8.4 Severability. If any provision of this Warrant Agreement shall be invalid or unenforceable in any respect for any reason, the validity and enforceability of any such provision in any other respect and of the remaining provisions of this Warrant Agreement shall not be in any way impaired.

8.5 Attorneys Fees. If any suit or action is filed by any party to enforce this Warrant Agreement or otherwise with respect to the subject matter of this Warrant Agreement, the prevailing party shall be



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entitled to recover reasonable attorneys fees incurred in preparation or in prosecution or defense of such suit or action as fixed by the court or courts in which the suit or action, including any appeal therein, is tried, heard or decided. Attorneys fees shall include fees of paralegals and deposition expenses, and shall further include attorneys fees incurred by any party in connection with any bankruptcy or similar proceeding.

8.6 Governing Law and Venue. This Warrant Agreement shall be governed by and construed in accordance with the laws of the State of New York. If any suit or action is filed by any party to enforce this Warrant Agreement or otherwise with respect to the subject matter of this Warrant Agreement, venue shall be in the federal or state courts in New York, New York, unless venue there would prevent the joining of appropriate third parties.

IN WITNESS WHEREOF, the parties have executed this Warrant Agreement as of the date first above written.

**CASTLE BRANDS INC.**,
a Delaware corporation

By: ______________________________
Mark Andrews
Chairman and Chief Executive Officer

**INVESTOR**

______________________________

**EXHIBIT 31.1**

**SECTION 302 CERTIFICATION**

I, Mark Andrews, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Castle Brands Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) **[Reserved]**

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors or (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2006

/s/ Mark Andrews
Mark Andrews
Chairman & Chief Executive Officer
(Principal Executive Officer)

**EXHIBIT 31.2**

**SECTION 302 CERTIFICATION**

I, Keith A. Bellinger, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Castle Brands Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) **[Reserved]**

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors or (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2006

/s/ Keith A. Bellinger
Keith A. Bellinger
President and Chief Operating Officer
(Principal Financial Officer)

**EXHIBIT 32.1**

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Mark Andrews, the Chairman and Chief Executive Officer of Castle Brands Inc. (the ‘‘Registrant’’) and Keith A. Bellinger, the President and Chief Operating Officer of the Registrant, each hereby certifies that:

1. The Registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2006, (the ‘‘Periodic Report’’), fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Date: November 14, 2006

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|---|---|
| /s/ Mark Andrews | /s/ Keith A. Bellinger |
| Mark Andrews | Keith A. Bellinger |
| Chairman and Chief Executive Officer | President and Chief Operating Officer |
| (Principal Executive Officer) | (Principal Financial Officer) |