

Truett-Hurst, Inc.
Form 10-Q
November 14, 2013

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ending September 30, 2013

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: 333-187164

TRUETT-HURST, INC.

(Exact name of registrant as specified in its charter)

DELAWARE
**(State or other jurisdiction of
incorporation or organization)**

46-1561499
**(I.R.S. employer
identification number)**

4035 Westside Road, Healdsburg, California
(Address of principal executive offices)

95448
(zip code)

707.433.4423
(Registrant's telephone number, including area code)

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, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

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Yes No

Indicate the number of shares outstanding of each of the Issuer's classes of common stock, as of the latest practicable date.

Class	Number of Shares Outstanding
Common stock, no par value per share	2,700,000

**TRUETT-HURST INC. AND SUBSIDIARIES
FORM 10-Q**

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

TRUETT-HURST INC. AND SUBSIDIARIES
(Prior to June 26, 2013, H.D.D. LLC and Subsidiary)
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	September 30, 2013	June 30, 2013
	(unaudited)	
ASSETS		
Current assets:		
Cash	\$ 8,361	\$ 11,367
Accounts receivable	1,861	2,816
Inventories	17,117	13,222
Other current assets	436	245
Total current assets	27,775	27,650
Property and equipment, net	5,544	5,383
Goodwill	134	134
Intangible assets, net	689	706
Other assets, net	311	259
Total assets	\$ 34,453	\$ 34,132
 LIABILITIES and STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit	\$ 6,018	\$ 6,887
Accounts payable	2,967	2,123
Accrued expenses	1,478	1,710
Due to related parties	777	71
Current portion of deferred taxes	75	96
Current maturities of related party notes	71	70
Current maturities of long-term debt	251	250
Total current liabilities	11,637	11,207
Deferred rent liability	50	53
Deferred taxes, net of current portion	127	127
Related party notes, net of current maturities	49	67
Long-term debt, net of current maturities	3,391	3,454
Total liabilities	15,254	14,908

Commitments and contingencies (Note 8)

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Stockholders' equity		
Preferred stock, par value of \$0.001 per share, 5,000,000 shares authorized and zero issued and outstanding	-	-
Class A common stock, par value of \$0.001 per share, 7,000,000 authorized and 2,700,000 issued and outstanding	3	3
Class B common stock, par value of \$0.001 per share, 1,000 authorized and 10 issued and outstanding	-	-
Additional paid-in capital	11,091	10,977
Accumulated deficit	(3,500)	(3,467)
Total Truett-Hurst, Inc. equity	7,594	7,513
Non-controlling interests	11,605	11,711
Total equity	19,199	19,224
Total liabilities and stockholders' equity	\$ 34,453	\$ 34,132

See accompanying notes to condensed consolidated financial statements.

TRUETT-HURST INC. AND SUBSIDIARIES
(Prior to June 26, 2013, H.D.D. LLC and Subsidiary)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share data)
(unaudited)

	Three Month Periods Ended	
	September 30,	
	2013	2012
Sales	\$ 5,536	\$ 5,304
Less excise tax	(150)	(153)
Net sales	5,386	5,151
Cost of sales	3,597	3,521
Gross profit	1,789	1,630
Operating expenses:		
Sales and marketing	1,051	767
General and administrative	839	360
Bulk wine sales, net (gain)	-	(2)
Total operating expenses	1,890	1,125
Income (loss) from operations	(101)	505
Other income (expense):		
Interest expense	(42)	(121)
Changes in fair value of warrant and interest rate swap	(3)	(7)
Loss on foreign currency	(14)	-
Total other expense	(59)	(128)
Income (loss) before income taxes	(160)	377
Income tax expense (benefit)	(21)	1
Net income (loss) before non-controlling interests	(139)	376
Less: Net income (loss) attributable to non-controlling interest: The Wine Spies, LLC	(24)	(21)
Net income (loss) attributable to Truett-Hurst, Inc. and H.D.D. LLC	(115)	\$ 397
Less: Net income (loss) attributable to non-controlling interest: H.D.D. LLC	(82)	
Net loss attributable to Truett-Hurst, Inc.	\$ (33)	
Net loss per share:		
Basic and Diluted	\$ (0.01)	
Shares used in computing net loss per share:		
Basic and Diluted	2,700,000	

See accompanying notes to condensed consolidated financial statements.

TRUETT-HURST INC. AND SUBSIDIARIES
(Prior to June 26, 2013, H.D.D. LLC and Subsidiary)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Three Month Periods Ended	
	September 30,	
	2013	2012
Cash flows from operating activities:		
Net income (loss)	\$ (139)	\$ 376
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	121	67
Deferred rent	(3)	(1)
Deferred taxes	(21)	-
Contributed rent	-	36
Loss on fair value of warrant and interest rate swap	3	7
Stock-based compensation	114	-
Changes in operating assets and liabilities, net		
Accounts receivable	955	(856)
Inventories	(3,895)	(1,309)
Bulk wine deposit	-	220
Other assets, current	(195)	(26)
Accounts payable and accrued expenses	612	1,442
Net cash used in operating activities	(2,448)	(44)
Cash flows from investing activities:		
Acquisition of property and equipment	(247)	(340)
Acquisition of intangible and other assets	(71)	(40)
Acquisition of The Wine Spies, LLC	-	(275)
Proceeds from sale of assets	2	-
Net cash used in investing activities	(316)	(655)
Cash flows from financing activities:		
Net proceeds from (repayments on) line of credit	(869)	1,877
Advances from related parties	706	156
Payments on related party notes	(17)	-
Proceeds from long-term debt	-	3,382
Payments on long-term debt	(62)	(3,850)
Payments on amount due factor	-	(869)
Net cash provided by (used in) financing activities	(242)	696
Net decrease in cash	(3,006)	(3)
Cash at beginning of period	11,367	167
Cash at end of period	\$ 8,361	\$ 164
Supplemental disclosure of cash flow information:		
Interest paid during year	\$ 53	\$ 106
Income taxes paid during year, net of refunds	\$ 1	\$ 1

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Supplemental disclosure of non-cash transactions

Contributed rent for membership interest	\$	-	\$	36
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See accompanying notes to condensed consolidated financial statements.

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TRUETT-HURST INC. AND SUBSIDIARIES
(Prior to June 26, 2013, H.D.D. LLC and Subsidiary)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands)
(Unaudited)

NOTE 1 - BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The unaudited condensed consolidated financial statements for the three-month period ended September 30, 2013 and the June 30, 2013 balance sheet, include the results of Truett-Hurst, Inc. and its subsidiaries: H.D.D. LLC (“LLC”) and its consolidated subsidiary, The Wine Spies, LLC (“Wine Spies”) (collectively, “we,” “Truett-Hurst,” “our,” “us,” or “Company”). The unaudited condensed consolidated financial statements for the three-month period ended September 30, 2012 reflect the results of the LLC and Wine Spies. Truett-Hurst, Inc.’s fiscal 2013 period is from June 26, 2013 to June 30, 2013 due to the completion of the Company’s initial public offering (“IPO”) on June 25, 2013. Unless the context suggests otherwise, references in this report to Truett-Hurst Inc. refer (1) prior to the June 2013 IPO of Truett-Hurst Inc. and related transactions, to the LLC and its consolidated subsidiary and (2) after our IPO and related formation transactions, to Truett-Hurst Inc. and its consolidated subsidiaries.

The accompanying unaudited condensed consolidated financial statements have been prepared by management in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. All intercompany transactions have been eliminated. Accordingly, the accompanying unaudited financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. We prepared the accompanying unaudited condensed consolidated financial statements on the same basis as the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013, and, in the opinion of management, these financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full fiscal year. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013 filed with the SEC on September 27, 2013.

Certain reclassifications have been made to these fiscal 2013 quarter condensed consolidated financial statements to conform to the current fiscal 2014 quarter presentation. Reclassifications had no material impact on previously reported results of operations, financial position or cash flows.

Unless otherwise indicated, the notes to the unaudited condensed consolidated financial statements relate to the discussion of our continuing operations.

Critical Accounting Policies and Estimates

Critical accounting policies are those we believe are most important to portraying our financial condition and results of operations and also require the greatest amount of subjective or complex judgments by management. The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of the 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. Judgments and uncertainties regarding the application of these policies and estimates may result in materially different amounts being reported under various conditions or using different assumptions. There have been no material changes to the critical accounting policies and estimates previously

disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013.

Accounting Pronouncements

We have reviewed all recently issued, but not yet effective, accounting pronouncements and we do not believe the future adoption of any such pronouncements may be expected to cause a material impact on our financial condition or the results of our operations.

TRUETT-HURST INC. AND SUBSIDIARIES
(Prior to June 26, 2013, H.D.D. LLC and Subsidiary)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands)
(Unaudited)

NOTE 2 - ACCOUNTS RECEIVABLE PLEDGED UNDER FACTORING AGREEMENT

In November 2011, January 2012 and April 2012, we entered into three agreements with a factor borrowing a total of \$2.6 million in order to finance three transactions with a vendor. We agreed to assign and sell receivables related to these transactions to the factor at a rate of 100% of each receivable plus 1.25% per month of the unpaid principal amount of the loan. We were fully and unconditionally liable for the principal and interest on the loans; therefore, we accounted for the transfer of receivables as a secured financing. Interest expense includes finance costs associated with these factoring activities.

With the addition of John D. Fruth to our board of directors the factor agreement became a related party agreement. The April 2012 agreement for the amount due of \$0.9 million as of June 30, 2012 was paid subsequent to fiscal 2012 year end. Interest of nil and \$0.03 million was paid under these agreements for the three-month periods ended September 30, 2013 and 2012, respectively.

NOTE 3 INVENTORIES

Inventories consisted of the following:

	2013 September 30, (in thousands)	June 30,
Bulk wine	\$ 4,671	\$ 6,245
Bottled wine	11,780	6,688
Merchandise and other	495	165
Capitalized cultural costs	171	124
	\$ 17,117	\$ 13,222

NOTE 4 OTHER CURRENT ASSETS

Other current assets as of September 30, 2013, include the fair market value of an interest rate swap for \$0.1 million and other prepaid amounts of \$0.3 million. Other current assets as of June 30, 2013, include the fair market value of the interest rate swap for \$0.1 million and other prepaid amounts of \$0.1 million.

NOTE 5 PROPERTY AND EQUIPMENT, net

Property and equipment consisted of the following:

	2013 September 30, (in thousands)	June 30,
Land and land improvements	\$ 2,804	\$ 2,804

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Building and improvements	1,740	1,740
Machinery and equipment	1,106	960
Vineyard development	353	353
Vineyard equipment	330	330
Furniture and fixtures	161	158
Leasehold improvements	66	66
Vehicles	81	77
	6,641	6,488
Less accumulated depreciation and amortization	(1,097)	(1,105)
Total fixed assets	\$ 5,544	\$ 5,383

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TRUETT-HURST INC. AND SUBSIDIARIES
(Prior to June 26, 2013, H.D.D. LLC and Subsidiary)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands)
(Unaudited)

NOTE 5 PROPERTY AND EQUIPMENT, net, continued

Total depreciation and amortization expense for both three-month periods ended September 30, 2013 and 2012 was \$0.1 million.

NOTE 6 GOODWILL AND INTANGIBLE ASSETS, net

In August 2012, we entered into a membership purchase interest agreement with an individual to purchase a 50% interest in Wine Spies, to further develop our presence in on-line wine sales. We hold three of the four management control positions and therefore have consolidated the business as of the acquisition date. Non-controlling interest is shown in the consolidated financial statements. Acquisition has been accounted for as a business combination. We recorded the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The fair values assigned to the identifiable intangible assets acquired were based on estimates and assumptions determined by management and totaled \$0.5 million. The intangibles are being amortized over their estimated lives ranging from four to ten years. We recorded the excess of consideration transferred over the aggregate fair values as goodwill in the amount of \$0.1 million. The purchase consideration was \$0.3 million, consisting of cash and a non-interest bearing note, which was paid in full March 1, 2013.

Intangible asset balances are summarized as follows:

	2013 September 30, (in thousands)	June 30,
Finite lives:		
Customer lists	\$ 213	\$ 213
Trademarks	169	169
Proprietary technology	95	95
Non-compete agreement	38	38
Patent	29	25
	544	540
Less accumulated amortization	(115)	(91)
	429	449
Indefinite lives:		
Trademarks	260	257
	\$ 689	\$ 706

Total amortization expense of intangible assets and other assets was \$0.04 million for the three-month periods ended September 30, 2013 and 2012, respectively. Expected future amortization expense on intangible assets and other assets as of September 30, 2013 is as follows:

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Years ending June 30:
(in thousands)

2014	\$	113
2015		151
2016		150
2017		84
2018		47
Thereafter		195
	\$	740

TRUETT-HURST INC. AND SUBSIDIARIES
(Prior to June 26, 2013, H.D.D. LLC and Subsidiary)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands)
(Unaudited)

NOTE 7 OTHER ASSETS, net

Other assets consist of the following:

	2013 September 30, (in thousands)	June 30,
Label design costs	\$ 218	\$ 218
Loan fees	18	18
Lease costs - related party	23	23
Website design costs	41	41
Software	64	-
Other	1	1
	365	301
Less accumulated amortization	(54)	(42)
	\$ 311	\$ 259

NOTE 8 COMMITMENTS AND CONTINGENCIES*Leases*

In February 2011, we entered into a lease agreement with a related party, the Hambrecht Wine Group, to lease a tasting room and winery. The lease is for five years, commencing on March 1, 2011 and ending on February 29, 2016, and contains one option to extend for an additional period of five years. We have the right of first refusal in the event the related party desires to sell the leased property. Annual rent for the tasting room is \$0.1 million, due monthly. The winery rent is subject to adjustment based on the actual number of cases produced each year; however, future payments are based on a minimum number of cases, as specified in the agreement. Beginning on September 1, 2012 and annually thereafter, tasting room and winery rent is increased by 3%. Lease expense is accounted for on a straight-line basis. Future lease payment commitments total approximately \$0.7 million.

For the three-month periods ended September 30, 2013 and 2012, nil and \$0.04 million, respectively, of lease payments were applied to reduce the amount due from a member. Lease expense for the three-month periods ended September 30, 2013 and 2012 was \$0.07 million for both periods, respectively.

Credit Facilities

In June 2012, a bank extended the maturity date for a loan in order to allow us to finalize a new financing facility with a different bank. On July 16, 2012, we executed credit facilities with Bank of the West totaling \$13.0 million to provide funds for working capital needs, to refinance existing debt, and to purchase new equipment. The credit facilities are collateralized by substantially all of our assets, require compliance with certain financial covenants and are guaranteed by certain of our affiliates. The facilities include a line of credit for \$9.0 million that was funded in July 2012 that carries an interest rate of 1.75% above LIBOR and is due on or before May 31, 2014; \$0.1 million to

fund previously purchased capital equipment that was funded in August 2012 at a fixed interest rate of 3.75% and due on January 15, 2018; an incremental \$0.4 million capital equipment line to purchase new equipment that was funded in January 2013 at a fixed rate of interest of 3.75% and is due on January 15, 2018; a \$0.1 million foreign exchange facility that has not yet been funded, that carries a 10% credit percentage and allows us to enter into any spot or forward transaction to purchase from or sell to Bank of the West a foreign currency and is due on or before May 31, 2014; and a real estate loan for \$3.4 million that was funded in August 2012, that carries an interest rate of 2.25% above LIBOR. These funds were used to settle \$5.5 million of amounts due in the June 30, 2012 consolidated financial statements.

TRUETT-HURST INC. AND SUBSIDIARIES
(Prior to June 26, 2013, H.D.D. LLC and Subsidiary)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands)
(Unaudited)

NOTE 8 COMMITMENTS AND CONTINGENCIES, continued

As of September 30, 2012, we were not in compliance with certain financial covenants included in our credit facility. In March 2013, in connection with the bank issuance of a waiver for the financial covenants, we amended and restated a member warrant to allow for the immediate exercise of the warrant for a 3% member interest. The original common stock warrant, issued in May 2012, was for 20% of the contributed members' equity interest equal to \$0.5 million. The obligation was satisfied with the exercise of the warrant in March 2013 for \$0.5 million.

Additionally, \$0.7 million in related party obligations was subordinated and \$0.4 million of newly issued, convertible, subordinated debt was received from four members of the LLC. The debt bears interest at 10% per annum, with interest and principal due before March 1, 2014. Upon completion of the IPO on June 25, 2013, all amounts were released from subordination and paid in full.

The Bank of the West Loan contains usual and customary covenants, including, without limitation:

- limitation on incurring senior indebtedness;
- limitation on making loans and advances;
- limitation on investments, acquisitions, and capital expenditures;
- limitation on liens, mergers and sales of assets; and
- limitations on new activities of Truett-Hurst.

In addition, the Bank of the West Loan contains negative and financial covenants, including, without limitation, a minimum current assets to current liabilities ratio (measured quarterly), debt to effective tangible net worth ratio (measured quarterly) and debt service coverage ratio (measured annually). As of September 30, 2013, we were in compliance with all negative and financial covenants.

Related Party Notes Payable

We executed a \$0.2 million unsecured promissory note payable to Mark De Meulenaere, a member of the LLC, in connection with our repurchase of his Put Interest. The note bears interest at 4.5% per annum and is payable monthly in principal and interest payments of \$6,245, with any unpaid principal and interest due and payable on May 3, 2015.

In connection with his departure from Winery Exchange Inc. and the termination of his non-compete agreement, we agreed to reimburse Phillip L. Hurst, Director and Chief Executive Officer ("CEO") of the LLC and Truett-Hurst, Inc., in the amount of \$0.3 million, payable monthly in principal and interest payments of \$12,556. This amount accrued interest at a rate of 0.43% per annum and matured in November 2012. All amounts due under this agreement have been paid in full.

We executed a \$0.4 million note payable to Messrs. Hurst, Director and CEO of the LLC and Truett-Hurst, Inc., Paul Dolan and Heath Dolan, both Directors of the LLC and Truett-Hurst, Inc., in connection with operating capital needs.

The note bore interest at 6.5% per annum, with the entire principal balance and unpaid accrued interest due and payable on June 30, 2012. The note was paid in full with funds borrowed under the Bank of the West Loan.

TRUETT-HURST INC. AND SUBSIDIARIES
(Prior to June 26, 2013, H.D.D. LLC and Subsidiary)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands)
(Unaudited)

NOTE 8 COMMITMENTS AND CONTINGENCIES, continued

Note to a related party consisted of the following (in thousands, except payments in footnotes):

	2013 September 30, (in thousands)	June 30,
Related party notes:		
Note 1	(1) \$ 120	\$ 137
Less current maturities	(71)	(70)
Total related party notes	\$ 49	\$ 67

(1) Note payable to a member for the repurchase of a certain percentage of their ownership interest in the LLC; pursuant to exercise of put right; unsecured; payable monthly in principal and interest payments of \$6,245; matures in May 2015, at which time a lump sum payment for any remaining principal and interest is due; fixed interest rate of 4.5%.

Future principal and interest payments for the related party notes as of September 30, 2013 are as follows:

Years ending June 30: (in thousands)	
2014	\$ 53
2015	