Truett-Hurst, Inc.
Form 10-Q
May 15, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2015

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

For the transition period from __________ to __________

Commission File Number: 001-35973

TRUETT-HURST, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**46-1561499**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification number)**

125 Foss Creek Circle, Healdsburg, California	**95448**
(Address of principal executive offices)	**(zip code)**

(707) 431-4436

(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 x 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 (Do not check if a smaller reporting company)	¨	Smaller reporting company	x

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

Yes ¨ No x

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

Class A	**Number of Shares Outstanding**
Common stock, $0.001 par value per share	4,010,120

TRUETT-HURST INC. AND SUBSIDIARIES

FORM 10-Q

INDEX TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

TRUETT-HURST, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	March 31, 2015 Unaudited	June 30, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,072	$ 5,567
Accounts receivable	2,349	3,300
Inventories	22,269	17,179
Bulk wine deposit	1,122	1,424
Other current assets	106	161
Total current assets	27,918	27,631
Property and equipment, net	5,811	5,553
Goodwill	134	134
Intangible assets, net	732	629
Other assets, net	476	381
Total assets	$ 35,071	$ 34,328
LIABILITIES and EQUITY		
Current liabilities:		
Credit facilities	$ 8,865	$ 8,685
Accounts payable and accrued expenses	4,236	3,194
Accrual for sales returns	556	-
Due to related parties	201	56
Related party note	12	67
Current maturities of long-term debt	379	333
Total current liabilities	14,249	12,335
Deferred rent liability	32	48
Long-term debt, net of current maturities	3,345	3,527
Total liabilities	17,626	15,910

Commitments and contingencies (Note 5)		
Stockholders' equity		
Preferred stock, par value of $0.001 per share, 5,000,000 shares authorized and zero issued and outstanding at March 31, 2015 and June 30, 2014	-	-
Class A common stock, par value of $0.001 per share, 15,000,000 authorized and 4,010,120 issued and outstanding at March 31, 2015 and 3,750,472 issued and outstanding at June 30, 2014	4	4
Class B common stock, par value of $0.001 per share, 1,000 authorized and 8 issued and outstanding at March 31, 2015 and 9 issued and outstanding at June 30, 2014	-	-
Additional paid-in capital	14,516	14,057
Accumulated deficit	(4,829)	(3,995)
Total Truett-Hurst, Inc. stockholders' equity	9,691	10,066
Non-controlling interests	7,754	8,352
Total equity	17,445	18,418
Total liabilities and equity	$ 35,071	$ 34,328

See accompanying notes to condensed consolidated financial statements.

TRUETT-HURST, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share data)

(Unaudited)

	Three-Month Periods Ended March 31, 2015	Three-Month Periods Ended March 31, 2014	Nine-Month Periods Ended March 31, 2015	Nine-Month Periods Ended March 31, 2014
Sales	$ 6,278	$ 5,280	$ 19,624	$ 16,957
Less excise tax	(126)	(120)	(426)	(415)
Net sales	6,152	5,160	19,198	16,542
Cost of sales	3,723	3,408	12,335	10,880
Gross profit	2,429	1,752	6,863	5,662
Operating expenses:				
Sales and marketing	1,885	1,377	5,308	3,930
General and administrative	855	613	2,610	1,937
Provision for loss of deposit	-	400	-	400
Bulk wine sales, net gain	-	-	-	(1)
Loss on disposal of assets	10	-	12	-
Total operating expenses	2,750	2,390	7,930	6,266
Loss from operations	(321)	(638)	(1,067)	(604)
Other (expense) income:				
Interest expense, net	(74)	(42)	(207)	(123)
Other	(68)	(56)	(154)	(26)
Total other expense	(142)	(98)	(361)	(149)
Loss before income taxes	(463)	(736)	(1,428)	(753)
Income tax expense (benefit)	2	(111)	4	(100)
Net loss before non-controlling interests	(465)	(625)	(1,432)	(653)
Net (loss) income attributable to non-controlling interest: The Wine Spies, LLC	(27)	(13)	58	(74)
Net loss attributable to Truett-Hurst, Inc. and H.D.D. LLC	(438)	(612)	(1,490)	(579)
Less: Net loss attributable to non-controlling interest: H.D.D. LLC	(178)	(428)	(656)	(402)
Net loss attributable to Truett-Hurst, Inc.	$ (260)	$ (184)	$ (834)	$ (177)
Net loss per share				
Basic and diluted	$ (0.07)	$ (0.06)	$ (0.22)	$ (0.07)

Weighted average shares used in computing net loss per share:				
Basic and diluted	3,842,798	2,936,894	3,787,014	2,704,752

See accompanying notes to condensed consolidated financial statements.

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TRUETT-HURST, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine-Month Periods Ended March 31,	
	2015	2014
Cash flows from operating activities:		
Net loss before non-controlling interests	$ (1,432)	$ (653)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	496	394
Stock-based compensation	458	253
Loss (gain) on fair value of interest rate swap	98	(3)
Loss on disposal of asset	12	-
Deferred rent	(16)	(2)
Deferred taxes	2	(100)
Changes in operating assets and liabilities, net		
Accounts receivable	951	293
Inventories	(5,090)	(3,962)
Bulk wine deposit	302	(1,125)
Other current assets	(43)	44
Accounts payable and accrued expenses	1,042	(880)
Accrual for sales returns	556	-
Net cash used in operating activities	(2,664)	(5,741)
Cash flows from investing activities:		
Acquisition of property and equipment	(615)	(472)
Acquisition of intangible and other assets	(240)	(180)
Proceeds from sale of assets	3	1
Net cash used in investing activities	(852)	(651)
Cash flows from financing activities:		
Net proceeds (payments on) from line of credit	180	(305)
Net proceeds from related parties	90	208
Proceeds (payments to) on long-term debt	(249)	239
Net cash provided by financing activities	21	142
Net decrease in cash	(3,495)	(6,250)
Cash at beginning of period	5,567	11,367
Cash at end of period	$ 2,072	$ 5,117

Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 188	$ 125
Cash paid for income taxes	$ 2	$ 2
Supplemental disclosure of non-cash transactions		
Seller-financed acquisition of trademark	$ 170	$ -
Deferred tax asset arising from LLC unit exchange	$ 3,606	$ 2,791
Due to related parties pursuant to tax receivable agreement	$ 3,245	$ 2,512
Equity benefit on LLC unit exchange	$ 31	$ 279

See accompanying notes to condensed consolidated financial statements.

TRUETT-HURST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

NOTE 1 - BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The unaudited interim condensed consolidated financial statements include the results of Truett-Hurst, Inc. ("THI") 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 "the Company") and have been prepared, without audit, in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with general instructions for quarterly reports filed on Form 10-Q and Article 8 of Regulation S-X. We consolidate the financial results of the LLC and its consolidated subsidiary, and record a non-controlling interest which represents the portion of equity ownership in the aforementioned subsidiaries that is not attributable to us.

The accompanying unaudited financial statements do not include all of the information and footnotes required by GAAP for audited financial statements and 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, 2014 filed with the SEC on September 29, 2014. 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, 2014, 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 period presented are not necessarily indicative of the results expected for the full fiscal year. Unless otherwise indicated, the notes to the unaudited condensed consolidated financial statements relate to the discussion of our continuing operations.

Certain reclassifications have been made to the prior period unaudited condensed consolidated financial statements to conform to the current period presentation. Reclassifications had no material impact on previously reported results of operations, financial position or cash flows.

Quantities or results referred to as “to date” or “as of this date” mean as of March 31, 2015, unless otherwise specifically noted. References to “FY” or “fiscal year” refer to our fiscal year ending on June 30th the designated year.

Critical Accounting Policies and Estimates

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, 2014.

Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-05: Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement (“ASU 2015-05”). The amendments in this update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the update specifies that the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. The update further specifies that the customer should account for a cloud computing arrangement as a service contract if the arrangement does not include a software license. ASU 2015-05 will be effective for us in FY16. We are in the process of assessing the future impact of this update to the consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03: Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs (“ASU 2015-03”). The update sets forth a requirement that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs is not affected by the amendments in this update. ASU 2015-03 will be effective for us in FY16. We are in the process of assessing the future impact of this update to the consolidated financial statements.

We have reviewed all other 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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

NOTE 2 - INVENTORIES

Inventories consist of the following:

	March 31, 2015	June 30, 2014
	(in thousands)	
Grapes, bulk wine, and capitalized cultural costs	$6,725	$ 5,499
Bottled wine	15,059	11,285
Bottling materials and other	485	395
Total inventories	$22,269	$ 17,179

NOTE 3 - PROPERTY AND EQUIPMENT, net

Property and equipment consists of the following:

	March 31, 2015	June 30, 2014
	(in thousands)	
Land and land improvements	$2,804	$ 2,804
Building and improvements	1,805	1,756
Machinery and equipment	1,757	1,233
Vineyard development	353	353

Vineyard equipment	327	327
Furniture and fixtures	259	256
Leasehold improvements	120	117
Vehicles	93	93
	7,518	6,939
Less accumulated depreciation	(1,707)	(1,386)
Total property and equipment, net	$5,811	$ 5,553

Total depreciation was $0.1 million and $0.3 million for the three-month and nine-month periods of FY15 compared to $0.1 million and $0.2 million for the same prior-year periods of FY14, respectively.

NOTE 4 - INTANGIBLE ASSETS AND OTHER ASSETS, net

We performed our annual impairment review of goodwill, indefinite lived intangible and finite lived assets as of April 1, 2015. Under the authoritative guidance we elected to perform a qualitative assessment for our impairment testing. Based on our qualitative assessment, we concluded that it was more likely than not that the fair value of goodwill, indefinite lived intangible and finite lived assets were greater than their carrying amounts, and therefore no further testing or impairment was required. Our qualitative analysis included macroeconomic and industry and market specific considerations, financial performance indicators and measurements, and other factors. Historically, we have recorded no impairment charges.

TRUETT-HURST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

NOTE 4 - INTANGIBLE ASSETS AND OTHER ASSETS, net, continued

Intangible asset balances are summarized as follows:

	March 31, 2015	June 30, 2014
	(in thousands)	
Finite lives:		
Customer lists	$ 213	$ 213
Trademarks	169	169
Proprietary technology	95	95
Non-compete agreement	38	38
Patent	44	42
	559	557
Less accumulated amortization	(264)	(189)
	295	368
Indefinite lives:		
Trademarks	437	261
Total intangible assets, net	$ 732	$ 629

Other assets balances are summarized as follows:

	March 31, 2015	June 30, 2014
	(in thousands)	
Label design costs	$ 419	$ 247

Loan fees	18	18
Lease costs - related party	23	23
Software	144	144
Website design costs	58	55
Other	1	1
	663	488
Less accumulated amortization	(187)	(107)
Total other assets, net	$ 476	$ 381

Total amortization expense of intangible assets and other assets was $0.05 million and $0.2 million for the three-month and nine-month periods of FY15 compared to $0.04 million and $0.1 million for the same prior-year periods of FY14, respectively. The following table presents the expected future amortization expense for intangible assets and other assets at March 31, 2015:

Years ending June 30: (in thousands)	
2015 (remaining three months)	$ 59
2016	230
2017	162
2018	129
2019	83
Thereafter	108
Total future amortization expense	$ 771

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TRUETT-HURST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

NOTE 5 - COMMITMENTS AND CONTINGENCIES

Leases

In February 2011, we entered into a lease agreement for 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 lessor desires to sell the leased property. Beginning on September 1, 2012 and annually thereafter, tasting room and winery rent is increased by 3%. Additionally, the winery rent is increased if actual case production exceeds a specified number of cases. Current and anticipated production levels are below this minimum and as such the winery rent increase is controlled by the annual 3% increase clause. Lease expense is accounted for on a straight-line basis.

In October 2013, we entered into a lease agreement for administrative office space. The lease commenced on October 15, 2013 and ends on October 31, 2016, and contains three one-year renewal options with adjustment to market rents.

Lease payments for these facilities was $0.1 million and $0.2 million for the three-month and nine-month periods of FY15 compared to $0.08 million and $0.2 million for the same prior-year periods of FY14, respectively. At March 31, 2015, future lease payment commitments for these facilities totaled approximately $0.3 million.

Credit Facilities and Notes Payable

Since June 30, 2014, there have been no material changes with respect to our credit facilities and/or borrowings as disclosed in the “Notes to the Financial Statements - Commitments and Contingencies” in our Annual Report on Form 10-K for the fiscal year ended June 30, 2014.

The credit facilities, which mature on July 31, 2015, include (a) a revolving line of credit with a maximum commitment of $9.0 million which accrues interest at 1.75% above the London Interbank Offered Rate ("LIBOR"), (b) a capital equipment line with a maximum commitment of $0.5 million which carries an interest rate of 2.25% above floating One-Month LIBOR, and (c) a foreign exchange facility with a maximum commitment of $0.1 million which allows to enter into any spot or forward transaction to purchase from or sell to our bank a foreign currency. We did not use the foreign exchange facility during the three and nine-month periods ended March 31, 2015. As of March 31, 2015 we had availability under our revolving credit facility of $0.6 million. The outstanding balances on the components of the credit facilities are:

	March 31, 2015	June 30, 2014
	(in thousands)	
Credit Facilities		
Line of credit	$8,365	$ 8,648
Equipment line of credit	500	37
Total credit facilities	$8,865	$ 8,685

The credit facilities are secured by a pledge of substantially all of our assets and availability is subject to compliance with certain covenants, including, without limitation, a minimum current assets to current liabilities ratio (measured quarterly), a debt to effective tangible net worth ratio (measured quarterly) and a debt service coverage ratio (measured annually at our fiscal year end). We were in compliance in all material aspects with all such covenants at March 31, 2015.

We are currently working with our lender and we believe that we will be able to renew our credit facilities prior to July 31, 2015.

TRUETT-HURST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

Long-term debt consisted of the following:

		March 31, 2015	June 30, 2014
		(in thousands, except payments in footnotes)	
Long term debt:			
Note 1	(1)	$ 3,022	$ 3,122
Note 2	(2)	33	70
Note 3	(3)	210	263
Note 4	(4)	346	405
Note 5	(5)	113	-
Total notes payable		3,724	3,860
Less current maturities		(379)	(333)
Total long term debt		$ 3,345	$ 3,527

(1) Note payable to a bank, secured by a deed of trust on property, payable monthly with principal payments of $11,270 plus interest, matures May 31, 2022, variable interest of 2.25% above LIBOR.

(2) Note payable to a bank, secured by equipment, payable monthly with principal and interest payments of $4,226, matures November 1, 2015 at 3.75% interest.

(3) Note payable to a bank, secured by equipment, payable monthly with principal and interest payments of $6,535, matures January 15, 2018 at 3.75% interest.

(4) Note payable to a bank, secured by equipment, payable monthly with principal and interest payments of $7,783, matures March 1, 2019; at 3.75% interest.

(5) On November 30, 2014, we acquired the unrestricted use of the Stonegate trademark in exchange for a trademark release payment which is to be made over time and is accounted for as a note payable. The note payable has three equal installments: a) within five days of November 30, 2014, b) on October 15, 2015, and c) on July 31, 2016. The note does not accrue interest outstanding on the principal. An imputed interest rate of 5.5% was assessed under GAAP and the impact was considered immaterial.

Long-term debt future principal and interest payments are as follows:

Years ending June 30:	
(in thousands)	
2015 (remaining three months)	$84
2016	368
2017	353
2018	269
2019	204
Thereafter	2,446
	3,724
Add: Estimated interest	768
Total	$4,492

Related Party Note

Other than payments, there have been no material changes with respect to our related party loan as disclosed in the "Notes to the Consolidated Financial Statements - Commitments and Contingencies" in our Annual Report on Form 10-K for the fiscal year ended June 30, 2014.

TRUETT-HURST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

NOTE 5 - COMMITMENTS AND CONTINGENCIES, continued

Related party future principal and interest payments are as follows:

		March 31, 2015		June 30, 2014	
		(in thousands, except payments in footnotes)			
Related party note:					
Note	(1)	$	12	$	67
Less current maturities			(12)		(67)
Total related party note		$	-	$	-

(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%.

Supply Contract

At March 31, 2015, total future purchase commitments for finished goods total approximately $4.0 million and are expected to be fulfilled during fiscal 2015 to 2017.

We enter into short and long-term contracts to supply a portion of our future grapes and bulk wine inventory requirements with third parties and related party growers. As of March 31, 2015, future minimum inventory commitments are as follows:

Years ending June 30:	Related Parties	Total

	Third Parties (in thousands)		
2015	$3,710	$ 273	$3,983
2016	666	273	939
2017	91	273	364
2018	-	273	273
Thereafter	-	-	-
Total	$4,467	$ 1,092	$5,559

Subsequent to March 31, 2015, we have entered into additional grape contracts totaling approximately $0.7 million payable during FY16 and FY17.

Guarantees

There have been no material changes with respect to our guarantees as disclosed in the "Notes to the Consolidated Financial Statements - Commitments and Contingencies" in our Annual Report on Form 10-K for the fiscal year ended June 30, 2014.

Litigation

From time to time, we may be subject to various litigation matters arising in the ordinary course of business. We are not aware of any current pending legal matters or claims, individually or in the aggregate, that are expected to have a material adverse impact on our consolidated financial position, results of operations, or cash flows.

Exchange Agreement

Prior to the completion of the IPO, we entered into an exchange agreement with the existing owners of the LLC, several of whom are directors and/or officers. Under the exchange agreement, each existing owner (and certain permitted transferees thereof) may (subject to the terms of the exchange agreement), exchange their LLC Units for shares of Class A common stock of the Company on a one-for-one basis, subject to customary conversion rate adjustments for stock splits, stock dividends and reclassifications, or for cash, at our election. As a holder exchanges their LLC Units, our interest in the LLC will be correspondingly increased. During FY14, certain members exchanged 0.9 million LLC units, on a one-for-one basis, for shares of Class A common stock of the Company, under the exchange agreement.

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TRUETT-HURST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

NOTE 5 - COMMITMENTS AND CONTINGENCIES, continued

Thus far during FY15, certain LLC members have exchanged a cumulative total of 0.2 million LLC units, on a one-for-one basis, for shares of our Class A common stock, under the exchange agreement. See Note 8 – Stockholders' Equity for the total LLC units converted during the third quarter of FY15.

Tax Receivable Agreement

We entered into a tax receivable agreement with the LLC unit holders which provides for payment by the Company to the LLC unit holders who convert their units to shares, an amount equal to 90% of the amount of the benefit, if any, that are realized as a result of (i) increases in tax basis associated with the election effected under Section 754 of the Code, and (ii) certain other tax benefits related to our entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement. Any payments under the tax receivable agreement will depend upon whether we have taxable income to utilize the benefit.

We will be required to pay the counterparties to the tax receivable agreement for certain tax benefits we may claim arising in connection with current exchanges, future purchases or exchanges of LLC Units and related transactions, and the amounts we may pay could be significant.

H.D.D. LLC intends to make an election under Section 754 of the Internal Revenue Code (the "Code") effective for each taxable year in which an exchange of LLC Units for shares of Class A common stock as described above occurs, which may result in an adjustment to the tax basis of the assets of H.D.D. LLC at the time of an exchange of LLC Units. As a result of these exchanges, THI will become entitled to a proportionate share of the existing tax basis of the assets of H.D.D. LLC. In addition, the purchase of LLC Units and subsequent exchanges are expected to result in increases in the tax basis of the assets of H.D.D. LLC that otherwise would not have been available.

Both this proportionate share and these increases in tax basis may reduce the amount of tax that THI would otherwise be required to pay in the future. These increases in tax basis may also decrease gains (or increase losses) on future dispositions of certain capital assets to the extent tax basis is allocated to those capital assets.

During the third quarter of FY15, we recorded deferred tax assets of $0.01 million related to the exchange of 0.09 million LLC units for an equal amount of THI Class A common stock. As of March 31, 2015, we recorded a $0.01 million long-term liability due to LLC unit holders who converted their units to shares which represents 90% of the estimated tax benefits and an immaterial amount related to the difference in the recorded deferred tax asset and computed TRA liability and recorded as an adjustment to equity. As of March 31 2015, we recorded a valuation allowance on our deferred tax assets for $0.01 million as it was determined that it was more likely than not that the tax benefits would not be realized which resulted in corresponding adjustments to the TRA liability and equity as mentioned above.

Generally, a maximum obligation under these contracts is not explicitly stated. Because the specific amounts associated with these types of agreements are stated, the overall maximum amount of the obligation cannot be reasonably estimated. Historically, we have not been required to make payments under these obligations, and no liabilities have been recorded at March 31, 2015 and June 30, 2014, for these obligations on our balance sheets.

NOTE 6 - ACCOUNTS PAYABLE and ACCRUED EXPENSES

Accounts payable and accrued expenses consist of the following:

	March 31, 2015	**June 30, 2014**
	(in thousands)	
Accounts payable	$ 2,402	$ 2,746
Accrued inventory purchases	607	-
Accrued expenses	284	107
Bottling services	249	-
Commission	100	163
Distributor obligations	431	29
Personnel	149	114
Professional fees	14	35
Total accounts payable and accrued expenses	$ 4,236	$ 3,194

TRUETT-HURST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

NOTE 7 - STOCK-BASED COMPENSATION

Equity Incentive Plan

On February 4, 2013, we granted 0.2 million shares of restricted stock to an independent contractor who serves as our Creative Director. The award vests over three years, and had a fair value at the date of grant of $0.9 million for a 5% interest in the LLC. We record the fair value and recognize the associated expense per FASB ASC Subtopic 505-50, *Equity - Equity Based Payments to Non-Employees* which defines the measurement date as the earlier of the date at which the commitment for performance is reached, or the date at which the performance is complete. The grant date fair value of restricted stock awards, to non-employees, is recognized as compensation cost, on a straight-line basis over the three-year vesting period, and subject to periodic market adjustments as the underlying equity instruments vest. As of March 31, 2015, the stock was valued at $0.9 million. We recognized $0.7 million in cumulative expense and had $0.2 million of unrecognized stock compensation expense through March 31, 2015, related to the non-vested restricted stock award that is expected to be recognized over a weighted average period of approximately 0.85 years.

On December 9, 2013, we granted 0.01 million shares of restricted stock to certain directors of our company which vests over three years and has a fair value at date of grant of $0.03 million. The fair value of restricted stock, measured on the date of grant using the price of the Company's common stock on grant date, is recognized as compensation cost on a straight-line basis over the three-year vesting period. As of December 31, 2014, we reduced the vesting term to two years to match the director's term. As of March 31, 2015, we recognized $0.02 million in cumulative expense and had $0.01 million of unrecognized stock compensation expense related to the non-vested restricted stock award that is expected to be recognized over a weighted average period of approximately 0.69 years.

On June 25, 2014, we granted 0.2 million stock options, with the right to purchase Company Class A common shares, to our Chief Financial Officer/Chief Operations Officer. The stock options vest over four years and had a fair value at date of grant of $0.4 million. We account for our employee stock options under the fair value method of accounting using a Black-Scholes valuation model to measure stock option expense at the date of grant. The expected life assumptions for employee grants are based upon the simplified method, which averages the contractual term of the options of ten years with the average vesting term of four years for an average of six years. The risk-free interest rate is based on the expected U.S. Treasury rate over the expected life. Volatility reflects movements in our stock price over the most recent historical period equivalent to the expected life. The dividend yield assumption of zero is based upon the fact we have never paid cash dividends and presently have no intention of paying cash dividends in the future. The fair value of the stock option is recognized as compensation cost, on a straight-line basis over the four-year vesting period. As of March 31, 2015, we recognized $0.1 million in cumulative expense and had $0.3 million of unrecognized stock-based compensation expense that is expected to be recognized over a weighted average period of approximately 3.24 years.

On June 25, 2014, we granted 0.1 million shares of restricted stock units to our Chief Financial Officer/Chief Operations Officer which vest over four years and had a fair value at date of grant of $0.4 million. The grant date fair value of RSU awards is recognized as compensation cost, on a straight-line basis over the four-year vesting period. As of March 31, 2015, we recognized $0.1 million in cumulative expense and had $0.3 million of unrecognized stock-based compensation expense that is expected to be recognized over a weighted average period of approximately 3.24 years.

On November 20, 2014, during our annual stockholders meeting, our stockholders approved an amendment to our 2012 Stock Incentive Plan (“2012 Plan”), to increase the number of shares of Class A common stock reserved for issuance under the 2012 Plan by 0.7 million shares or from 0.3 million shares to 1.0 million shares.

On December 15, 2014, we granted 0.01 million shares of restricted stock to certain directors of our company which vested immediately upon grant and had a fair value at date of grant of $0.05 million and recognized expense as of December 31, 2014. The fair value of restricted stock was measured on grant date using the Company’s common stock price on grant date.

On December 15, 2014, we granted 0.01 million shares of restricted stock to certain directors of our company which vests over one year and has a fair value at date of grant of $0.06 million. The fair value of restricted stock, measured on the date of grant using the price of the Company’s common stock on grant date, is recognized as compensation cost, on a straight-line basis over the one - year vesting period. As of March 31, 2015, we recognized $0.02 million in cumulative expense and had $0.04 million of unrecognized stock-based compensation expense that is expected to be recognized over a weighted average period of approximately 0.71 years.

On December 15, 2014, we granted 0.01 million shares of restricted stock to a director of our company which vests over three years and has a fair value at date of grant of $0.03 million. The fair value of restricted stock, measured on the date of grant using the price of the Company’s common stock on grant date, is recognized as compensation cost, on a straight-line basis over the one - year vesting period. As of March 31, 2015, we recognized an immaterial amount of cumulative expense and had $0.03 million of unrecognized stock-based compensation expense that is expected to be recognized over a weighted average period of approximately 2.71 years.

TRUETT-HURST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

NOTE 7 - STOCK-BASED COMPENSATION, continued

A summary of our restricted stock award activity is presented below (shares and weighted grant date fair value not in thousands):

	Number of Shares	Weighted Average Grant Date Fair Value Per Share
Outstanding at June 30, 2014	148,928	$ 4.89
Granted	35,201	3.80
Vested	(86,800)	3.43
Forfeited, canceled or expired	-	-
Outstanding at March 31, 2015	97,329	$ 3.91

The following table summarizes stock-based compensation included in our unaudited condensed consolidated statements of operations for the three-month and nine-month periods of FY15 and FY14, respectively:

	Three-Month Periods Ended		**Nine-Month Periods Ended**	
	March 31, 2015	**March 31, 2014**	**March 31, 2015**	**March 31, 2014**
	(in thousands)			
Sales and marketing	$ 40	$ 40	$ 224	$ 224
General and administrative	75	11	234	29
Total stock-based compensation	$ 115	$ 51	$ 458	$ 253

NOTE 8 - STOCKHOLDERS' EQUITY

Stockholders' Equity

At our annual stockholders meeting on November 20, 2014, our stockholders approved an amendment to our Certificate of Incorporation to increase the authorized number of shares of our Class A common stock from 7.0 million shares to 15.0 million shares.

LLC Units

During the third quarter of FY15, there 0.09 million of LLC units converted for an equal amount of our Class A common stock. The following table presents the changes in the LLC units and the non-controlling interests in the LLC:

	Members LLC Units	THI Units	Total Units	LLC Member %	THI %	Total %
	(share data and percentages not in thousands)					
Balance as of June 30, 2013	4,102,644	2,700,000	6,802,644	60.3 %	39.7 %	100 %
LLC units converted FY14Q3	(815,778)	815,778	-	-12.0 %	12.0 %	0 %
LLC units converted FY14Q4	(122,694)	122,694	-	-1.8 %	1.8 %	0 %
Balance as of June 30, 2014	3,164,172	3,638,472	6,802,644	46.5 %	53.5 %	100 %
LLC units converted FY15Q2	(80,712)	80,712	-	-1.2 %	1.2 %	0 %
LLC units converted FY15Q3	(92,134)	92,134	-	-1.4 %	1.4 %	0 %
Balance as of March 31, 2015	2,991,326	3,811,318	6,802,644	43.9 %	56.1 %	100 %

Until November 17, 2014, we were a controlled company because our existing owners controlled 53.2% of the voting power of our outstanding Class A common stock and 100% of the voting power of our outstanding Class B common stock and had agreed to vote their shares of common stock together as a group. As a result of a certain member terminating the voting agreement and LLC unit conversions, we are no longer a "controlled company" within the meaning of the NASDAQ Capital Marketplace rules and, thus, are required to have at least a majority of independent directors on the Nominating and Governance Committee and Compensation Committee within 90 days of the date on which we ceased being a controlled company and to have fully independent Committees and a majority of independent directors on the Board of Directors within one year of the date on which we ceased to be a controlled company. We are in compliance with the above NASDAQ Capital Market rules.

TRUETT-HURST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

NOTE 9 - NET LOSS PER SHARE

The following table sets forth the computation of basic and diluted net loss per common share for three-month and nine-month periods of FY15:

	Three-Month Period Ended March 31, 2015	Nine-Month Period Ended March 31, 2015
	(in thousands, except share data)	
Net loss attributable to Truett-Hurst, Inc.	$ (260)	$ (834)
Loss Per Share		
Basic and dilutive Class A common weighted average shares	3,842,798	3,787,014
Basic and diluted loss per share	$ (0.07)	$ (0.22)

Basic net loss per share is computed by dividing net loss attributable to us, by the weighted average number of common shares outstanding for the period. Diluted net loss per share is computed by giving effect to all potential dilutive common shares, including convertible LLC units and equity incentive shares. The assumed exchange of 3.0 million LLC units for Class A common stock and the vesting of 0.3 million equity incentive shares have been excluded from the diluted loss per share because they are expected to have an anti-dilutive effect.

The following table sets forth the computation of basic and diluted net loss per common share for three-month and nine-month periods of FY14:

	Three-Month Period Ended	Nine-Month Period Ended

	March 31, 2014	March 31, 2014
	(in thousands, except share data)	
Net loss attributable to Truett-Hurst, Inc.	$ (184)	$ (177)
Loss Per Share		
Basic and dilutive Class A common weighted average shares	2,936,894	2,704,752
Basic and diluted loss per share	$ (0.06)	$ (0.07)

For FY14, the assumed exchange of 3.3 million LLC units for Class A common stock and the vesting of 0.2 million equity incentive shares have been excluded from the diluted loss per share because they were considered to have an anti-dilutive effect.

The shares of Class B common stock do not share in our earnings and therefore are not participating securities. Accordingly, basic and diluted net income per share of Class B common stock has not been presented.

NOTE 10 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The carrying amount reflected in the consolidated balance sheets of financial assets and liabilities, which includes cash, accounts receivable, accounts payable and accrued expenses, approximated their fair values due to the short term nature of these financial assets and liabilities. The carrying amount of our debt approximates its fair value.

In October 2012, we executed an interest rate swap obligation that was measured using observable inputs such as the LIBOR and Ten-year Treasury interest rates, and therefore has been categorized as Level 2. Level 2 is defined as inputs other than quoted prices in active markets that are observable either directly or indirectly in active markets. This derivative is not designated as a hedging instrument and has been recorded at fair value on our consolidated balance sheets. Changes in the fair value of this instrument have been recognized in our consolidated statements of operations in other income (expense).

TRUETT-HURST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)

(Unaudited)

NOTE 10 - FAIR VALUE OF FINANCIAL INSTRUMENTS, continued

The following tables set forth our interest rate swap fair values at March 31, 2015 and at June 30, 2014:

	Fair Value Measurements at Reporting Date (in thousands)	
	Fair Value as of March 31, 2015	**Significant Other Observable Inputs** (Level 2)
Assets		
Interest rate swap [1]	$ (32)	$ (32