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Alliance Distributors Holding Inc.
Form 10-Q
November 14, 2006

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: 000-32319

ALLIANCE DISTRIBUTORS HOLDING INC.

(Exact name of registrant as specified in its charter)

Delaware

33-0851302

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

1160 Commerce Avenue, Bronx, New York

11462

(Address of principal executive offices)

(Zip Code)

(718) 536-2248

(Registrant's telephone number, including area code)

15-15 132nd Street, College Point, New York 11356

(Former name, former address and former fiscal year, if
changed since last report)

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

Indicate by check mark whether the registrant is a shell company (as
defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

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

Class	Outstanding at October, 31
Common Stock, \$.001 par value per share	48,721,065 shares

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ALLIANCE DISTRIBUTORS HOLDING INC.
BALANCE SHEETS
(In Thousands, except per share amounts)

September 30,	De
2006	--
-----	--
Unaudited	De

ASSETS

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CURRENT ASSETS:		
Cash and equivalents	\$ 258	\$
Accounts receivable-net	4,877	
Inventory	6,029	
Due from vendors	431	
Prepaid acquisition and proposed offering costs	--	
Prepaid expenses and other current assets	380	
Deferred income taxes	323	
	-----	---
Total current assets	12,298	
PROPERTY AND EQUIPMENT - NET	688	
OTHER ASSETS	97	
	-----	---
TOTAL	\$ 13,083	\$
	=====	==
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Notes payable - bank	\$ 4,959	\$
Accounts payable	4,632	
Current portion of long term obligations	13	
Accrued expenses and other current liabilities	308	
	-----	---
Total current liabilities	9,912	
	-----	---
DEFERRED LEASE OBLIGATIONS	62	
	-----	---
LONG TERM OBLIGATIONS	6	
	-----	---
STOCKHOLDERS' EQUITY:		
Series A Convertible Non-Redeemable Preferred Stock, \$.001 par value; 8,530 and 8,615 shares authorized; 262 and 347 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively	--	
Common stock, \$.001 par value; 100,000 shares authorized; 48,721 and 47,369 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively	49	
Additional paid-in capital	3,379	
Accumulated deficit	(325)	
	-----	---
Total stockholders' equity	3,103	
	-----	---
TOTAL	\$ 13,083	\$
	=====	==

See notes to financial statements

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ALLIANCE DISTRIBUTORS HOLDING INC.
STATEMENTS OF OPERATIONS
THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005
(In thousands, except per share amounts)
(Unaudited)

	Three Months		Nine
	2006	2005	2006
NET SALES	\$ 15,453	\$ 13,566	\$ 42,040
COST OF GOODS SOLD	14,093	12,035	37,470
GROSS PROFIT	1,360	1,531	4,570
OPERATING COSTS AND EXPENSES:			
Selling and administrative expenses	1,654	1,187	4,267
Terminated transaction costs	--	--	257
Total operating expenses	1,654	1,187	4,524
(LOSS) INCOME FROM OPERATIONS	(294)	344	46
Interest expense	177	119	551
(LOSS) INCOME BEFORE (BENEFIT FROM) PROVISION FOR INCOME TAXES	(471)	225	(505)
(Benefit from) provision for income taxes	(188)	3	(201)
NET (LOSS) INCOME	\$ (283)	\$ 222	\$ (304)
Net loss per share - basic	\$ (.01)	\$ --	\$ (.01)
Net loss per share - diluted	\$ (.01)	\$ --	\$ (.01)
Weighted average common shares outstanding - basic	48,721	46,417	48,538
Weighted average common shares outstanding - diluted	48,721	49,122	48,538

See notes to financial statements

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NINE MONTHS ENDED SEPTEMBER 30, 2006
(In thousands)
(Unaudited)

	Preferred Shares	Stock A Amount	Common Shares	Stock Amount	Additional Paid in Capital
	-----	-----	-----	-----	-----
Balance, January 1, 2006	347	\$ --	47,369	\$ 47	\$ 3,22
Conversion of Preferred Stock A into Common Stock	(85)	--	1,352	2	(
Stock option compensation expense					15
Net loss	--	--	--	--	--
	-----	-----	-----	-----	-----
Balance, September 30, 2006	262	\$ --	48,721	\$ 49	\$ 3,37
	=====	=====	=====	=====	=====

See notes to financial statements

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ALLIANCE DISTRIBUTORS HOLDING INC. STATEMENTS OF CASH FLOWS NINE MONTHS ENDED SEPTEMBER 30, 2006 and 2005 (In thousands) (Unaudited)

	2006 -----
OPERATING ACTIVITIES:	
Net loss	\$ (304)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:	
Gain from insurance recovery	(105)
Deferred rent	36
Depreciation and amortization	94
Bad debt expense	56
Stock option compensation expense	156
Amortization of deferred financing costs	90
Deferred income taxes	(168)
Changes in operating assets and liabilities:	
Accounts receivable	594
Inventory	(660)
Due from vendors	308
Prepaid acquisition and proposed offering costs	162
Prepaid expenses and other current assets	(72)
Accounts payable	598
Accrued expenses and other current liabilities	(84)

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Net cash provided by (used in) operating activities	701

INVESTING ACTIVITIES:	
Purchase of property and equipment	(590)
Proceeds from insurance claim	124
Increase in other assets	(41)

Net cash used in investing activities	(507)

FINANCING ACTIVITIES:	
Proceeds from note payable - bank	41,514
Repayments of note payable - bank	(41,691)
Payments for registration and issuance costs	--
Payment of long-term obligations	(11)

Net cash (used in) provided by financing activities	(188)

INCREASE (DECREASE) IN CASH AND EQUIVALENTS	6
CASH AND EQUIVALENTS, BEGINNING OF PERIOD	252

CASH AND EQUIVALENTS, END OF PERIOD	\$ 258
	=====
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:	
Cash paid during the period for:	
Interest	\$ 484
	=====
Income taxes	\$ 100
	=====

See notes to financial statements

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ALLIANCE DISTRIBUTORS HOLDING INC. Notes to Unaudited Financial Statements

Note 1 - THE COMPANY AND INTERIM FINANCIAL STATEMENTS

Alliance Distributors Holding Inc. (the "Company" or "Alliance") is a distributor of video game consoles, peripherals, accessories and software to customers throughout the United States for most key manufacturers and third party publishers in the video game industry. The Company operates as a single segment.

On July 21, 2005, the Company and Abrams/Gentile Entertainment Inc. ("Age") entered into an operating agreement in which the Company and Age became members in Alliance Age LLC, a limited liability company formed in Delaware, to set forth the terms on which the parties will develop and commercialize products they mutually agree upon from time to time. The Company owns 65% of Alliance Age LLC. As of September 30, 2006, Alliance Age LLC was inactive.

The accompanying unaudited financial statements have been prepared in accordance

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with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. This Form 10-Q should be read in conjunction with the Company's financial statements and notes included in the 2005 Annual Report on Form 10-KSB. In the opinion of management, all material adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation, have been included in the accompanying unaudited financial statements.

The results of operations for the interim periods are not necessarily indicative of the results that maybe expected for the full year ending December 31, 2006.

Note- 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Allowance for Doubtful Accounts

The Company establishes credit terms for new clients based upon management's review of their credit information and projects terms, performs ongoing credit evaluations of its customers, adjusting credit terms when management believes appropriate based upon payment history and an assessment of their current credit worthiness. The Company records an allowance for doubtful accounts for estimated losses resulting from the inability of its clients to make required payments. The Company determines this allowance by considering a number of factors, including the length of time trade accounts receivable are past due, previous loss history, estimate of the client's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. While credit losses have generally been within expectations and the provisions established, the Company cannot guarantee that credit loss rates in the future will be consistent with those experienced in the past. In addition, the Company has credit exposure if the financial condition of one of its major clients were to deteriorate. In the event that the financial condition of its clients were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be necessary. It is reasonably possible that the Company's estimate of the allowance for doubtful accounts will change. As of September 30, 2006 and December 31, 2005, the Company's allowance for doubtful accounts totaled approximately \$236,000 and \$181,000, respectively.

Inventory

Inventory consists entirely of finished goods held for sale and is reported at the lower of cost or market, on the average cost basis. The Company receives price protection from certain of its suppliers for merchandise that may be slow moving or aged. The Company evaluates the adequacy of its slow moving or aged inventory quarterly and writes down its inventory to fair value based upon the price protection received or current market value. While write-downs have been within expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same level of write-downs as in the past. At times, the Company makes advance payments to vendors to procure and ensure delivery of certain high demand products. Such deposits are reflected as due from vendors in the balance sheet. The Company does not offer warranties to its customers but will accept returns of product claimed to be defective and reimburse the customers for the full purchase price. The majority of the Company's suppliers in turn accept these returns from us. There are no reserves for warranties as of September 30, 2006 and December 31, 2005.

Income Taxes

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The Company accounts for income taxes using the liability method which requires the recognition of deferred tax assets or liabilities for the temporary differences between the financial reporting and tax bases of the Company's assets and liabilities and for tax carry forwards at enacted statutory rates in effect for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. In addition, valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted net income per share is computed by dividing the net income by the weighted average number of common shares and common equivalent shares outstanding during the period.

The denominator for diluted net income per share for the three months ended September 30, 2005 includes 262,000 and 2,443,000 shares issuable upon conversion of warrants and Series A Convertible Non-Redeemable Preferred Stock, respectively.

Common equivalents for the three and nine months ended September 30, 2006 exclude 1,969,000 for common shares issuable upon exercise of warrants and 2,101,000 common shares issuable upon conversion of Series A Convertible Non-Redeemable Preferred Stock since their effect would be anti-dilutive. Common equivalents for the nine months ended September 30, 2005 exclude 500,000 for common shares issuable upon exercise of warrants and 403,000 for common shares issuable upon conversion of Series A Convertible Non-Redeemable Preferred Stock since their effect would be anti-dilutive.

Stock Based Compensation

Pursuant to Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB 25") prior to January 1, 2006 the Company accounted for stock based employee compensation arrangements using the intrinsic value method. Accordingly, no compensation expense was recorded in the financial statements with respect to options granted to employees, since the options were granted at or above market value.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), "Share Based Payment" ("SFAS No. 123(R)") which eliminates the use of APB 25 and the intrinsic value method of accounting, and requires companies to recognize the cost of employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements. The Company has adopted the modified prospective method whereby compensation cost is recognized in the financial statements beginning with the effective date based on the requirements of SFAS No. 123(R) for all share-based payments granted after that date and for all unvested awards granted prior to that date.

The following table illustrates the effect on net income (loss) and income (loss) per share for the three and nine months ended September 30, 2005 (in thousands, except per share amounts) if the Company had applied the fair value recognition provisions of SFAS No. 123(R) to stock-based employee compensation.

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	Three months ended September 30, 2005 -----	Nine months ended September 30, 2005 -----
Net income (loss) as reported	\$ 222	\$ (243)
Deduct: Total stock-based employee compensation determined under fair value based method, net of related tax effects	(53) -----	(161) -----
Pro forma net income (loss)	\$ 169 =====	\$ (404) =====
Income (loss) per share:		
Basic - as reported	\$ 0.00 =====	\$ (0.01) =====
Basic - pro forma	\$ 0.00 =====	\$ (0.01) =====
Diluted - as reported	\$ 0.00 =====	\$ (0.01) =====
Diluted - pro forma	\$ 0.00 =====	\$ (0.01) =====

The fair value of the options-pricing model was calculated with the following weighted-average assumptions used for grants during the nine months ended September 30, 2005: risk-free interest rate 4.25-4.5%; expected life 6.5 years; expected volatility 55-126%. The fair value generated by the Black-Scholes model may not be indicative of the future benefit, if any, that may be received by the option holder. There were no grants of options during the three and nine months ended September 30, 2006.

Recent Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48) "Accounting for Uncertainty in Income Taxes" which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Furthermore, FIN 48 provides guidance on the recognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The Company is in the process of determining the effect of FIN 48, if any, on its financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108 (SAB 108) "Considering the Effects of Prior Year Misstatements in Current Year Financial Statements." SAB 108 provides guidance on quantifying financial statement misstatements, including the effects of prior year errors on current year financial statements. SAB 108 is effective for periods ending after November 15, 2006. The Company is in the process of determining the effect of SAB 108 if any, on its financial statements.

In September 2006, the FASB issued SFAS No. 157 "Fair Value Measures" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value

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measurements, however it does not apply to SFAS 123R. This Statement shall be effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including any financial statements for an interim period within that fiscal year. The provisions of this statement should be applied prospectively as of the beginning of the fiscal year in which this Statement is initially applied, except in some circumstances where the statement shall be applied retrospectively. The Company is currently evaluating the effect, if any, of SFAS 157 on its financial statements.

Note 3 - FINANCING AGREEMENT

The Company has a financing agreement with Rosenthal & Rosenthal, Inc. ("Rosenthal") dated November 11, 2004 and amended on November 1, 2005 (the "Agreement"). Under the Agreement, Rosenthal may in its discretion lend to the Company up to \$10,000,000, which is the maximum credit under the facility, based on eligible inventory and receivables. All borrowings are due on demand, are secured by substantially all of the assets of the Company and are subject to the Company's compliance with certain financial covenants. The Company's CEO and the Company's President have signed limited guaranties in respect of borrowings under the Agreement.

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The amendment dated November 1, 2005 among other things increased the maximum credit under the facility from \$5,000,000 to \$10,000,000 and reduced the interest rate on borrowings by 0.5%.

The Agreement terminates November 30, 2007 unless earlier terminated by Rosenthal on 30 days' notice. Interest accrues on outstanding borrowings at the prime rate (but not less than 4.75%) plus 1.5%. At September 30, 2006, the interest rate on borrowings outstanding was 9.75%. In addition, the Company is obligated to pay the lender on each anniversary date an annual fee of 1% of the maximum credit which is amortized over one year, and a monthly administrative fee of \$1,000. The financing expense for the annual fee recorded totaled approximately \$25,000 and \$12,500 for the three months ended September 30, 2006 and 2005, respectively, and approximately \$75,000 and \$50,000 for the nine months ended September 30, 2006 and 2005, respectively.

In connection with establishing the Agreement, the Company issued to Rosenthal a warrant (the "Warrant") to purchase 500,000 shares of common stock at \$0.10 per share. The Warrant expires on November 30, 2010. On notice by the Company the Warrants will expire earlier if the closing price of the common stock during a period designated in the Warrants is not less than \$0.40 per share. The Warrants may be exercised by Rosenthal at \$.10 per share for cash or on a cashless basis (i.e., by deducting from the number of shares otherwise issuable on exercise a number of shares that have a then market value equal to the exercise price). The Company recorded a deferred financing cost of approximately \$60,000 in the fourth quarter 2004, representing the fair value of the warrants, which is amortized over the life of the financing agreement of three years. The financing expense recorded for the three months ended September 30, 2006 and 2005 totaled approximately \$5,000 and \$4,500, respectively, and for the nine months ended September 30, 2006 and 2005 amounted to approximately \$15,000 and \$13,500, respectively.

Under the terms of the Agreement, the Company is required to maintain a specified level of net worth, working capital and debt ratios as defined. On March 21, 2006, the Company and Rosenthal agreed to amend the covenants, effective December 31, 2005. On August 9, 2006, the Company and Rosenthal agreed to amend and increase the capital expenditures covenant, effective September 30,

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2006. As of September, 30, 2006, the Company did not comply with certain financial covenants for which Rosenthal has provided a waiver.

The Company believes that it will have sufficient liquidity for the next twelve months and the foreseeable future. However, the Company would be materially and adversely affected if Rosenthal demands payment of these borrowings under the Agreement and if the Company is unable to refinance these borrowings.

Note 4 - LITIGATION

In October 2006, the Company paid \$200,000 in settlement of a legal proceeding that had been brought against Essential Reality, Inc. (a predecessor of the Company), Essential Reality, LLC and David Devor, a former officer and a current employee of the Company, for rent and costs relating to premises formerly occupied by the Company. As of December 31, 2005, the Company had accrued \$125,000 against the potential outcome of the litigation. For the nine months ended September 30, 2006, the Company accrued an additional \$75,000, resulting in an aggregate liability of \$200,000 accrued at September 30, 2006.

Note 5 - TERMINATED TRANSACTION COSTS

On April 26, 2006, the Company announced that it would not acquire Foto Electric Supply Co., Inc. (Fesco). An agreement by the Company to acquire Fesco had expired by its terms on February 28, 2006, and subsequent discussions to extend and amend the agreement ended. As a result, the Company recorded a charge of approximately \$257,000 in the first quarter of 2006 for its costs in the terminated transaction.

Note 6 - COMMITMENTS

On June 8, 2006, the Company entered into an agreement to lease approximately 25,000 square feet of space located in New York City, of which approximately 18,000 and 7,000 square feet will be utilized for warehouse and office space, respectively. The lease has a five-year term commencing on June 1, 2006 and expiring on May 31, 2011, unless otherwise extended by the Company under an option to extend the term for an additional five-year term expiring on May 31, 2016. The annual base rent is \$295,000 for the first year of the term (payable in 12 equal monthly payments of approximately \$24,583, with an abatement equal to approximately \$24,583 for the first rental payment) and increases 3.5% on June 1st of each year beginning with June 1, 2007. In the event the Company exercises the option, the annual base rent will continue to increase at the 3.5% annual rate.

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On June 13, 2006, the Company entered into a lease agreement for approximately 7,000 square feet of space located in Miami, Florida, of which approximately 5,000 and 2,000 square feet will be used for warehouse and showroom/office space, respectively. The lease has a five-year term commencing on June 1, 2006. The annual base rent is \$56,400 for the first two years of the term (payable in monthly payments of \$4,700), and increases 2.0% on June 1st of each year beginning with June 1, 2008. In addition, the Company is obligated to pay condominium maintenance fees (currently \$600 per month), real property taxes (currently \$800 per month) and all applicable sales tax.

In October 2006, the Company entered into a two year employment agreement with its Chief Financial Officer (the "Officer"). The agreement provides for annual base compensation of \$210,000 per annum as well as for insurance and other fringe benefits, and contains confidentiality and non-compete and non-interference provisions. The Company may terminate the employment under the agreement without cause (as defined) at any time, provided that, in such case,

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the Company will, as severance, continue to pay an amount equal to his then base salary in normal payroll installments, subject to withholding, for six months or if less until September 30, 2008. In addition, the Company will pay the cost of COBRA for the period during which severance is payable as aforesaid. In addition, the Company granted an option effective on October 3, 2006 to purchase 100,000 shares of the Company's common stock under the Company's stock option plan at an exercise price of \$0.18 per share. The option has a 10 year term, and vests in 12 equal installments on the last day of each of the 12 calendar quarters beginning with the calendar quarter that begins on October 1, 2006, but only so long as the Officer is employed by the Company on the last day of such calendar quarter.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD - LOOKING STATEMENTS

The following discussion of our financial condition and results of operations should be read together with the financial statements and related notes included elsewhere in this report. Some of the statements in this section that are not historical facts are forward-looking statements. You are cautioned that the forward-looking statements contained in this section are estimates and predictions, and that our actual results could differ materially from those anticipated in the forward-looking statements due to risks, uncertainties or actual events differing from the assumptions underlying these statements. The risks, uncertainties, and assumptions include, but are not limited to, those disclosed in our annual report on Form 10-KSB for our fiscal year ended December 31, 2005.

OVERVIEW

Our distribution revenues are derived from the sale of interactive video games and gaming products for all key manufacturers and third-party software titles, accessories and hardware. Operating margins in our distribution business are dependent on the mix of software and hardware sales, with software generating higher margins than hardware.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Certain of our accounting policies require the application of significant judgment by us in selecting the appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. These judgments are based on historical experience, observation of trends in the industry, information provided by customers and information available from other outside sources, as appropriate. Critical accounting policies include:

Revenue Recognition - We recognize sales upon shipment of products to customers as title and risk of loss pass upon shipment and collectibility is reasonably assured. We provide provisions for estimated uncollectible discounts and rebates to customers, estimated returns and allowances and other adjustments in the same period the related sales are recorded. While such amounts have been within expectations and the provisions established, we cannot guarantee that we will continue to experience the same rates as in the past.

Accounts Receivable - Accounts Receivable as shown on the Balance Sheet are net of allowances and anticipated discounts. We establish credit terms for new clients based upon a review of their credit information and perform ongoing

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credit evaluations of our customers, adjusting credit terms when we believe appropriate based upon payment history and an assessment of their current credit worthiness. The allowance for doubtful accounts is determined through analysis of the aging of accounts receivable at the date of the financial statements for estimated losses resulting from the inability of its clients to make required payments. We determine this allowance by considering a number of factors, including the length of time trade accounts receivable are past due, previous loss history, estimate of the client's current ability to pay its obligation to us, and the condition of the general economy and the industry as a whole. While credit losses have generally been within expectations and the provisions established, we cannot guarantee that credit loss rates in the future will be consistent with those experienced in the past. In addition, we have credit exposure if the financial condition of one of our major clients were to deteriorate. In the event that the financial condition of its clients were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be necessary. It is reasonably possible that our estimate of the allowance for doubtful accounts will change. As of September 30, 2006 and December 31, 2005, our allowance for doubtful accounts approximated \$236,000 and \$181,000, respectively.

Inventories - Inventory is stated at the lower of cost or market, cost being determined on the average cost basis. We receive price protection from certain of our suppliers for merchandise that may be slow moving or aged. We evaluate the adequacy of our slow moving or aged inventory quarterly and write down inventory to fair value based upon the price protection received or current market value. While write-downs have been within expectations and the provisions established, we cannot guarantee that we will continue to experience the same level of write-downs as in the past. We do not offer warranties to our customers but will accept returns of product claimed to be defective and reimburse the customers for the full purchase price. The majority of our suppliers in turn accept these returns from us. There are no reserves for warranties as of September 30, 2006 and December 31, 2005.

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Income Taxes - At December 31, 2005, we had federal and state net operating loss carryforwards (NOL's) of approximately \$5.5 million. In accordance with SFAS No. 109, "Accounting for Income Taxes", we establish valuation allowances if it is "more likely than not" that we will not be able to utilize the NOLs to offset future taxes. We have established a valuation allowance for the full amount of the December 31, 2005 NOL due to the uncertainty surrounding the realization of the NOL's which resulted from a transaction under a Share Exchange Agreement in June 2004 by and among us (formerly Essential Reality, Inc.) and Jay Gelman, Andre Muller and Francis Vegliante ("Exchange Agreement"). Pursuant to IRC Section 382 of the Tax Reform Act of 1986 the utilization of NOL's is limited in the case of certain transactions including significant changes in ownership interests. We have determined that based upon the terms of the Exchange Agreement, an ownership change pursuant to this Act has occurred and as a result, the NOL's are significantly limited.

FLUCTUATIONS IN OPERATING RESULTS AND SEASONALITY

We have experienced fluctuations in quarterly operating results as a result of the timing of the introduction of new titles; variations in sales of titles developed for particular platforms; market acceptance of our titles; sequels or enhancements of existing titles; projected and actual changes in platforms; the timing and success of title introductions by our competitors; product returns; changes in pricing policies by us and our competitors; order cancellations; and delays in product shipment. Sales of our titles are also seasonal, with peak shipments typically occurring in the fourth calendar quarter as a result of increased demand for titles during the holiday season. Quarterly comparisons of

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operating results are not necessarily indicative of future operating results.

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RESULTS OF OPERATIONS

Three Months Ended September 30, 2006 compared to Three Months Ended September 30, 2005:

The following table shows each specified item as a dollar amount (in thousands) and as a percentage of net sales for the three months ended September 30, 2006 and 2005, and should be read in conjunction with the financial statements included elsewhere in this Quarterly Report on Form 10-Q:

		Three Months ended ----- 2006 -----
Net sales	\$ 15,453	100.0%
Cost of goods sold	14,093	91.2%
	-----	-----
Gross profit	1,360	8.8%
Selling and administrative expenses	1,654	10.7%
	-----	-----
(Loss) income from operations	(294)	(1.9%)
Interest expense	177	1.1%
	-----	-----
(Loss) income before (benefit from) provision for income taxes	(471)	(3.0%)
(Benefit from) provision for income taxes	(188)	(1.2%)
	-----	-----
Net (loss) income	\$ (283)	(1.8%)
	=====	=====

Net sales increased by \$1,887,000, or 14%, from \$13,566,000 for the three months ended September 30, 2005 to \$15,453,000 for the three months ended September 30, 2006. The growth in net sales was primarily due to the increase in sales with our existing customers, as well as an increase in our customer base.

Cost of goods sold increased by \$2,058,000, or 17%, from \$12,035,000 for the three months ended September 30, 2005 to \$14,093,000 for the three months ended September 30, 2006. The increase is principally attributable to the increase in net sales. Gross profit as a percentage of net sales decreased to 8.8% for the three months ended September 30, 2006 from 11.3% for the three months ended September 30, 2005. This decrease in gross margin reflects higher discounts provided to customers as an inducement to increase volume. Cost of goods sold excludes the distribution costs of purchasing, receiving, inspection, warehousing and handling costs; we include these costs in our selling, general

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and administrative expenses. Our gross margins may not be comparable to those of other entities since some entities include these distribution costs in the cost of goods sold. Distribution costs were approximately \$342,000 and \$288,000 for the three months ended September 30, 2006 and 2005, respectively.

Selling and administrative expenses increased by \$467,000, or 39%, from \$1,187,000 for the three months ended September 30, 2005 to \$1,654,000 for the three months ended September 30, 2006. The increase was primarily the result of approximately \$104,000 in increased rent and utilities attributable to new warehouse and showroom facilities in New York and Florida, approximately \$100,000 for increased payroll, commissions and related payroll costs, approximately \$100,000 expensed this period for a \$200,000 settlement of a legal proceeding (see Part II, Item 1), and approximately \$41,000 related to equity-based compensation resulting from the adoption of SFAS 123(R). The remaining increase is attributable to various general increases in selling and administrative expenses. Selling and administrative expenses as a percentage of net sales increased to 10.7% for the three months ended September 30, 2006 from 8.7% for the three months ended September 30, 2005. For the three months ended September 30, 2006, selling and administrative expenses were comprised of the following: \$192,000 in selling expenses, \$342,000 in distribution costs and \$1,120,000 in administrative expenses. For the three months ended September 30, 2005, selling and administrative expenses were comprised of the following: \$172,000 in selling expenses, \$288,000 in distribution costs and \$727,000 in administrative expenses.

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Interest expense increased by \$58,000, or 49%, from \$119,000 for the three months ended September 30, 2005 to \$177,000 for the three months ended September 30, 2006. The increase was primarily due to higher interest rates on bank borrowings and increased borrowings. The increased borrowing levels were the result of increased sales volume that required higher inventory levels and increased accounts receivable.

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Nine Months Ended September 30, 2006 compared to Nine Months Ended September 30, 2005

The following table shows each specified item as a dollar amount (in thousands) and as a percentage of net sales for the nine months ended September 30, 2006 and 2005, and should be read in conjunction with the financial statements included elsewhere in this Quarterly Report on Form 10-Q:

	2006		Nine Months ended September 30, 2005	
Net sales	\$ 42,040	100.0%	\$ 36,000	100.0%
Cost of goods sold	37,470	89.1%	32,000	88.9%
Gross profit	4,570	10.9%	4,000	11.1%

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Operating costs and expenses:

Selling and administrative expenses	4,267	10.1%	3
Terminated transaction costs	257	0.7%	
	-----	-----	-----
 Total operating expenses	 4,524	 10.8%	 3
	-----	-----	-----
 Income from operations	 46	 0.1%	
 Interest expense	 551	 1.3%	
	-----	-----	-----
 Loss before (benefit from) provision for income taxes	 (505)	 (1.2%)	
 (Benefit from) provision for income taxes	 (201)	 (0.5%)	
	-----	-----	-----
 Net loss	 \$ (304)	 (0.7%)	 \$
	=====	=====	=====

Net sales increased by \$5,361,000 or 15% from \$36,679,000 for the nine months ended September 30, 2005 to \$42,040,000 for the nine months ended September 30, 2006. The growth in net sales was primarily due to the increase in sales with our existing customers, as well as an increase in our customer base.

Cost of goods sold increased by \$4,635,000 or 14%, from \$32,835,000 for the nine months ended September 30, 2005 to \$37,470,000 for the nine months ended September 30, 2006. The increase was consistent with revenue growth. Gross profit as a percentage of net sales increased slightly to 10.9% for the nine months ended September 30, 2006 from 10.5% for the nine months ended September 30, 2005. Cost of goods sold excludes the distribution costs of purchasing, receiving, inspection, warehousing and handling costs; we include these costs in our selling, general and administrative expenses. Our gross margins may not be comparable to those of other entities since some entities include these distribution costs in the cost of goods sold. These distribution costs were approximately \$996,000 and \$804,000 for the nine months ended September 30, 2006 and 2005, respectively.

Selling and administrative expenses increased by \$528,000 or 14%, from \$3,739,000 for the nine months ended September 30, 2005 to \$4,267,000 for the nine months ended September 30, 2006. The increase was primarily the result of increases in freight out expenses of approximately \$171,000, due primarily to fuel increases, approximately \$190,000 for increased payroll, commissions and related payroll costs, costs, approximately \$121,000 related to equity-based compensation resulting from the adoption of SFAS 123(R), approximately \$134,000 in increased rent and utilities attributable to new warehouse and showroom facilities in New York and Florida and the settlement of a legal proceeding. These increases were in part offset by a decrease in professional fees of \$113,000 consisting primarily of decreased accounting and legal fees related to Company SEC filings and a \$105,000 gain from insurance proceeds for replacement value of assets in excess of book value that were damaged a result of a fire near our former 132nd Street location. Selling, general and administrative expenses as a percentage of net sales decreased slightly to 10.1% for the three months ended September 30, 2006 from 10.2% for the nine months ended September 30, 2005. For the three months ended September 30, 2006, selling and administrative expenses were comprised of the following: \$588,000 in selling expenses, \$996,000 in distribution costs and \$2,683,000 in administrative expenses. For the nine months ended September 30, 2005, selling and administrative expenses were comprised of the following: \$543,000 in selling

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expenses, \$804,000 in distribution costs and \$2,392,000 in administrative expenses.

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We expensed terminated transaction costs of \$257,000, or 1.0% of sales, in the first quarter of 2006 as a result of our decision not to acquire Foto Electric Supply Co., Inc. An agreement by the Company to acquire Fesco had expired by its terms on February 28, 2006, and subsequent discussions to extend and amend the agreement ended.

Interest expense increased by \$211,000, or 62%, from \$340,000 for the nine months ended September 30, 2005 to \$551,000 for the nine months ended September 30, 2006. The increase was primarily due to higher interest rates on bank borrowings and increased borrowings. The increased borrowing levels were the result of increased sales volume that required higher inventory levels and increased accounts receivable.

LIQUIDITY AND CAPITAL RESOURCES

For the nine months ended September 30, 2006 net cash provided by operating activities was approximately \$701,000. Net cash provided by operations for the nine months ended September 30, 2006 consisted of a net loss of approximately \$304,000, offset by net changes in operating assets and liabilities totaling approximately \$846,000 and non-cash charges, net of non-cash credits for deferred income taxes and an insurance recovery gain, approximating \$159,000. For the nine months ended September 30, 2005, we used net cash in operating activities of approximately \$233,000, which principally consisted of a net loss of approximately \$243,000 and net changes in operating assets and liabilities totaling approximately \$266,000, offset by non-cash charges approximating \$276,000.

For the nine months ended September 30, 2006, we used \$507,000 cash for investing activities compared to \$89,000 cash used for investing activities in the comparable period in 2005. For the nine months ended September 30, 2006 we purchased \$590,000 of property and equipment, of which approximately \$500,000 was in connection with our move to a new warehouse, showroom and executive offices in New York City, and approximately \$20,000 was for our new warehouse in Florida, which we opened in September 2006. Cash used in investing activities for the nine months ended September 30, 2006 was in part offset by insurance proceeds for replacement value of assets in excess of book value that were damaged a result of a fire near our former 132nd Street location totaling approximately \$124,000.

Net cash used in financing activities for the nine months ended September 30, 2006 was approximately \$188,000 which primarily consisted of net repayments on our note payable to bank approximating \$177,000. For the nine months ended September 30, 2005, net proceeds on our note payable to bank approximated \$237,000.

We have a financing agreement (the "Agreement") with Rosenthal & Rosenthal, Inc. ("Rosenthal") pursuant to which Rosenthal may in its discretion lend to us up to \$10,000,000, which is the maximum credit under the facility, based on eligible inventory and receivables. All borrowings are due on demand, are secured by substantially all of our assets, and require us to be in compliance with certain financial covenants. Our CEO and our President have signed limited guaranties in respect of borrowings under the Agreement.

The Agreement terminates November 30, 2007 unless earlier terminated by Rosenthal on 30 days' notice. Interest accrues on outstanding borrowings at the prime rate (but not less than 4.75%) plus 1.5%. At September 30, 2006, the

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interest rate on borrowings outstanding was 9.75%. In addition, we are obligated to pay the lender on each anniversary date an annual fee of 1% of the maximum credit which is amortized over one year, and a monthly administrative fee of \$1,000. The financing expense for the annual fee recorded totaled approximately \$25,000 and \$12,500 for the three months ended September 30, 2006 and 2005, respectively, and approximately \$75,000 and \$50,000 for the nine months ended September 30, 2006 and 2005, respectively. At September 30, 2006 and December 31, 2005, we borrowed \$4,959,000 and \$5,135,000, respectively, under the facility.

In connection with establishing the Agreement, we issued to Rosenthal a warrant (the "Warrant") to purchase 500,000 shares of common stock at \$0.10 per share. The Warrant expires on November 30, 2010. On notice by the Company the Warrants will expire earlier if the closing price of the common stock during a period designated in the Warrants is not less than \$0.40 per share. The Warrants may be exercised by Rosenthal at \$.10 per share for cash or on a cashless basis (i.e., by deducting from the number of shares otherwise issuable on exercise a number of shares that have a then market value equal to the exercise price). We recorded a deferred financing cost of approximately \$60,000 in the fourth quarter 2004, representing the fair value of the warrants, which is amortized over the life of the financing agreement of three years. The financing expense recorded for the three months ended September 30, 2006 and 2005 totaled approximately \$5,000 and \$4,500, respectively, and for the nine months ended September 30, 2006 and 2005 amounted to approximately \$15,000 and \$13,500, respectively.

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Under the terms of the Agreement, we are required to maintain a specified level of net worth, working capital and debt ratios as defined. On March 21, 2006, we agreed with Rosenthal to amend the covenants, effective December 31, 2005. On August 9, 2006, Rosenthal further agreed to amend and increase the capital expenditures covenant, effective September 30, 2006. As of September 30, 2006, we did not comply with certain financial covenants for which Rosenthal has provided a waiver.

We believe we will have sufficient liquidity for the next twelve months and the foreseeable future. However, our business would be materially and adversely affected if Rosenthal demands payment of these borrowings under the Agreement and if we are unable to refinance these borrowings.

In September 2006, we relocated our offices, wholesale showroom, and warehouse to a 25,000 square foot facility located at 1160 Commerce Avenue in the Bronx, New York. The new facility, which provides almost 10,000 square feet more than our old facilities, is leased for a five year term with an option for us to extend the term for an additional 5 year term expiring on May 31, 2016. Annual base rent is \$295,000 for the first year of the term, with scheduled 3.5% increases each year commencing on June 1, 2007.

In addition, in September 2006 we opened a 7,000 square feet distribution facility and wholesale showroom in Miami, Florida.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of changes in value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates and equity prices. We have no financial instruments that give us exposure to foreign exchange rates or equity prices.

Our pre-tax earnings and cash flows are exposed to changes in interest rates as

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all borrowings under its credit facility bear interest at the prime rate (but not less than 4.75%) plus 1.5%. As of September 30, 2006, our note payable-bank bore interest at 9.75%. As of September 30, 2006, a hypothetical immediate 10% adverse change in prime interest rates relating to the note would have an approximate \$48,000 unfavorable impact on our earnings and cash flows over a one-year period, assuming the borrowing level remains consistent with the outstanding borrowings as of September 30, 2006. The fair value of the borrowings under the credit facility is not affected by changes in market interest rates.

ITEM 4. CONTROLS AND PROCEDURES

An evaluation has been carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and the operation of our "disclosure controls and procedures" (as such term is defined in Rules 13a-15(e) under the Securities Exchange Act of 1934) as of September 30, 2006 ("Evaluation Date"). Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, the disclosure controls and procedures are reasonably designed and effective to ensure that (i) information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

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PART 2. OTHER INFORMATION

Item numbers 2, 3, 4 and 5 are not applicable and have been omitted.

ITEM 1. LEGAL PROCEEDINGS

In October 2006, the Company paid \$200,000 in settlement of a legal proceeding that had been brought against Essential Reality, Inc. (a predecessor of the Company), Essential Reality, LLC and David Devor, a former officer and a current employee of the Company, for rent and costs relating to premises formerly occupied by the Company. As of December 31, 2005, the Company had accrued \$125,000 against the potential outcome of the litigation. For the nine months ended September 30, 2006, the Company accrued an additional \$75,000, resulting in an aggregate liability of \$200,000 accrued at September 30, 2006.

ITEM 1A. RISK FACTORS

We have a limited operating history and have engaged in our current business only since August 2003.

In November 2003, under prior management of the Company, we discontinued our business of manufacturing and selling a video controller. Our current videogame distribution business commenced operations on August 11, 2003 and was acquired by us in June 2004. We have not yet demonstrated our ability to operate profitably during a major downturn in our industry.

We may be unable to sell our existing inventory after announcements by major manufacturers of new platform launches.

We may be adversely affected if a current industry slowdown in consumer

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purchases of hardware models continues for a lengthy period of time. Because of the planned introduction of new system platforms from Sony Corporation, Nintendo, and shortages in Xbox 360 consoles from Microsoft, consumers often elect to wait for these new models instead of purchasing current systems, and this can cause a significant slowdown in industry revenues. If this were to continue and intensify, there would be a significant negative impact on our customers' ability to sell their existing inventory. As a result, orders for current systems would be reduced significantly, which would greatly limit our ability to sell these products. Although major manufacturers have traditionally reduced the prices of their current hardware models ahead of the launch of new systems, we cannot assure you that these manufacturers will continue this price reduction strategy. Even if manufacturers do reduce prices, we cannot assure you that any past success will result in increased purchases of existing systems ahead of new platform launches.

We are dependent on the contributions of our key executives and must maintain their services; Not entitled to key man proceeds.

Our success depends in large degree upon the skills of our senior management team and key employees and, in particular, Jay Gelman, our Chairman and CEO, and Andre Muller, our COO. An employment agreement with Mr. Gelman expired on June 30, 2006. None of such persons has expressed any intention to terminate or not commence services on our behalf, as the case may be. We have obtained only \$1,000,000 in key man insurance on the life of Mr. Gelman, and this policy has been assigned to the Company's senior lender. The loss of the services of any of these persons would have a material adverse effect on our business.

Gross margins relating to our business have been historically narrow which increases the impact of variations in costs on our operating results.

As a result of intense price competition, our gross margins in our business have historically been narrow and may continue to be narrow in the future. Accordingly, slight variations in operating costs and expenses could result in losses in our distribution business from period to period.

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We depend on a limited number of suppliers and have no long-term agreement with any suppliers.

Our ability to obtain particular products in required quantities and to fulfill customer orders on a timely basis is critical to our success. In most cases, we have no guaranteed price or delivery agreements with suppliers. In certain product categories, limited price concessions or return rights offered by publishers may have a bearing on the amount of product we may be willing to purchase. Our industry may experience significant hardware supply shortages from time to time due to the inability of certain manufacturers to supply certain products on a timely basis. As a result, we have experienced, and may in the future continue to experience, short-term hardware inventory shortages. In addition, we do not develop or manufacture any of the products we sell, but act solely as a distributor for the products of third parties. As such, we are entirely dependent on manufacturers or publishers who currently distribute their products through us, and who may, at any time, decide to distribute, or to substantially increase their existing distribution, through other distributors, or directly to retailers. During the nine months ended September

30, 2006, our three largest suppliers accounted for approximately 49% of our purchases (with one accounting for approximately 30% of such total purchases alone) and our ten largest suppliers in the aggregate accounted for approximately 75% of our purchases. Our distribution agreements with our major suppliers are generally terminable at any time by the suppliers on 30 days' prior written notice. In the event that we are unable to maintain our

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distribution arrangements with one or more of these significant suppliers, our business would be harmed and may not survive.

We would be adversely affected by a change in the marketing and distribution of videogame hardware systems and videogames by manufacturers.

Major manufacturers such as Sony, Nintendo and Microsoft, could change their marketing strategies and rely less on their current distributors to sell hardware systems and videogames. Since we depend on the products from these manufacturers for a significant portion of our revenues, this would adversely impact our financial situation, as there would be fewer products available for sale by us and our customers would be forced to look for other sources to procure the types of products we currently sell to them. Although we believe that there is only a limited risk that these manufacturers would significantly reduce their distribution of products through us, because of our high level of product penetration and strong customer base, we cannot assure you that one or more of these manufacturers will not take such action.

We have not entered into any distribution arrangement with Microsoft for distribution of its Xbox(R) product.

To date we have no direct business relationship with Microsoft Corporation ("Microsoft") for the distribution of its Xbox(R) game console. The Xbox and Xbox 360 consoles, currently represent an important segment of the videogame console market. To date, as a result of our inability to obtain a direct distribution arrangement with Microsoft for its Xbox products, we have had to purchase Xbox(R) products from one of Microsoft's distributors, thereby reducing our margins on these products. In the event that we are unable to acquire a direct distribution arrangement with Microsoft in the near future for the sale of Xbox products, including the newly-launched Xbox 360, our business could be adversely affected.

Our quarterly operating results may vary significantly, which could cause the price of our Common Stock to decline.

We have experienced and may continue to experience wide fluctuations in quarterly operating results. The interactive entertainment industry is highly seasonal, with sales typically higher during the fourth calendar quarter, due primarily to the increased demand for games during the holiday buying season. Our failure or inability to acquire products on a timely basis to meet seasonal fluctuations in demand may harm our business and operating results. These fluctuations could also cause the price of our Common Stock to decline. Other factors that cause fluctuations include:

- o delays in the introduction of new titles;
- o the size and timing of product and business acquisitions;
- o variations in sales of titles designed to operate on particular platforms;
- o availability of hardware platforms; o product returns and price concessions; and
- o the timing of orders from major customers.

Our expense levels are based, in part, on our expectations regarding future sales and therefore our operating results would be harmed by a decrease in sales or a failure to meet our sales expectations. The uncertainties associated with interactive entertainment software development, manufacturing lead times, production delays and the approval process for products by hardware manufacturers and other licensors make it difficult to predict the quarter in which products will ship and therefore may cause us to fail to meet financial expectations. In future quarters our operating results may fall below the expectations of securities analysts and investors. In this event, the market price of our Common Stock could significantly decline.

We are subject to the risk that our inventory values may decline and protective terms under supplier arrangements may not adequately cover the decline in values.

The interactive entertainment software and hardware industry is characterized by the introduction of new and enhanced generations of products and evolving industry standards. These changes may cause inventory to decline substantially in value or to become obsolete. We are also exposed to inventory risk in our distribution business to the extent that supplier price concessions are not available on all products or quantities and are subject to time restrictions. In addition, suppliers may become insolvent and unable to fulfill price concession obligations.

We have no long term agreements with any customer and we are dependent on a limited number of customers.

We do not have long-term purchase and sale agreements with any of our customers, and all of our sales to customers are made on a purchase order by purchase order basis. Although we believe that our customer base currently consists of approximately 2,600 retail stores located throughout the United States and Canada, with a majority being in the New York metropolitan area and surrounding tri-state region, during the nine months ended September 30, 2006, our largest customer accounted for 9% of our total sales, our top five customers accounted for 36% of our sales, our top ten customers accounted for 52% of our sales and our top 25 customers accounted for 68% of our sales. Since we have no long-term commitments with any of the customers to continue to purchase products from us, the loss of any of these customers could have a materially adverse effect on our business.

We hold no patents or material proprietary technology.

We have no intellectual property other than a trademark for "Video Game Alliance."

Unanticipated warranty costs could affect our ability to operate profitably.

We do not have any facilities for the repair or service of any products, and generally reimburse our customers in full for returns. Although the majority of our suppliers accept these returns from us, certain suppliers credit us with a fixed allowance for returns and require that we assume the risk of excess returns. We will be adversely affected if our returns for these suppliers exceed their return allowances.

Risks Related To Our Industry

Our business operates in a highly competitive environment.

The intense competition that characterizes our industry is based primarily on breadth, availability and quality of product lines; price; terms and conditions of sale; credit terms and availability; speed and accuracy of delivery; and effectiveness of sales and marketing programs. Our competitors include regional, national and international distributors, as well as hardware manufacturers and software publishers. There are several distributors in the United States that have revenues and financial resources and company history substantially greater than us. We are at a disadvantage to these companies and need to compete on the basis of the services we provide to our customers. We may lose market share or be forced in the future to reduce our prices in response to the actions of our competitors, and thereby experience a reduction in our gross margins.

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We may be adversely affected if the financial health of the U.S. retail industry should deteriorate.

We are subject to broad economic factors that drive consumer spending and maintain the health of the U.S. retail industry. These factors include, but are not limited to, unemployment rates, consumer credit levels, consumer confidence, and household discretionary income. If any of these or other economic factors should erode, consumer spending would fall and the U.S. retail industry would suffer a downturn. Consequently, our earnings would be adversely impacted by lower sales.

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We may be adversely affected by the trend towards retail trade consolidation.

As we pursue our retail distribution strategy, our sales will be contingent upon the favorable wholesale prices that we can obtain from retailers. If retailers merge or the retail industry consolidates, the larger, combined retailers will have significant pricing power because of the sheer size of their retail networks. As a result, we may not be able to obtain reasonable prices for the products we distribute. Consequently, our margins will decline and our results of operations would be reduced. There can be no assurance that we will be able to obtain reasonable wholesale prices for the products we distribute under a scenario where retailers merge and consolidate into larger entities.

The market for the titles we carry is characterized by short product life cycles.

The market for the titles we carry is characterized by short product life cycles and frequent introductions of new products. New products introduced may not achieve significant market acceptance or achieve sufficient sales to permit us to recover the amounts advanced by us to purchase such products, as well as our marketing costs. The life cycle of a game generally involves a relatively high level of sales during the first few months after introduction followed by a decline in sales. Because revenues associated with the initial shipments of a new product generally constitute a high percentage of the total revenues associated with the life of a product, any delay in the introduction of one or more new products or our ability to obtain such products on a timely basis, could adversely affect our operating results for particular periods.

Our business is cyclical, and we may fail to anticipate changing consumer preferences.

Our business is subject to all of the risks generally associated with the interactive entertainment industry, which has been cyclical in nature and has been characterized by periods of significant growth followed by rapid declines. Our future operating results will depend on numerous factors beyond our control, including:

- o the popularity, price and timing of new software and hardware platforms being released and distributed by us and our competitors;
- o international, national and regional economic conditions, particularly economic conditions adversely affecting discretionary consumer spending;
- o war, acts of terrorism and military action, which could adversely affect consumer preferences in entertainment;
- o changes in consumer demographics;

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- o the availability and popularity of other forms of entertainment; and
- o critical reviews and public tastes and preferences, all of which change rapidly and cannot be predicted.

In order to plan for acquisition and promotional activities, we must anticipate and respond to rapid changes in consumer tastes and preferences. A decline in the popularity of interactive entertainment or particular platforms could cause sales of the products we distribute to decline dramatically. The period of time necessary to develop new game titles, obtain approvals of manufacturers and produce finished products is unpredictable. During this period, consumer appeal for a particular title may decrease, causing product sales to fall short of expectations.

Rating systems for interactive entertainment software, potential legislation and consumer opposition could inhibit sales of the products we carry.

Trade organizations within the videogame industry require interactive entertainment software publishers to provide consumers with information relating to graphic violence, profanity or sexually explicit material contained in software titles, and impose penalties for noncompliance. We understand that certain countries have also established similar rating systems as prerequisites for sales of interactive entertainment software in such countries. Our suppliers' software titles receive a rating of "E" (age 6 and older), "T" (age 13 and over) or "M" (age 17 and over). Many of the new titles we carry have received an M rating. We do not know whether our supplies properly comply with such rating systems or properly display the ratings and content descriptions received for our titles.

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Several proposals have been made for federal legislation to regulate the interactive entertainment software, motion picture and recording industries, including a proposal to adopt a common rating system for interactive entertainment software, television and music containing violence or sexually explicit material, and the Federal Trade Commission has issued reports with respect to the marketing of such material to under-17 audiences. Consumer advocacy groups have also opposed sales of interactive entertainment software containing graphic violence or sexually explicit material by pressing for legislation in these areas (including legislation prohibiting the sale of certain "M" rated videogames to under-17 audiences) and by engaging in public demonstrations and media campaigns. Retailers may decline to sell interactive entertainment software containing graphic violence or sexually explicit material, which may limit the potential market for the "M" rated products we sell, and adversely affect our operating results. If any groups (including international, national and local political and regulatory bodies) were to target our suppliers' "M" rated titles, we might be required to discontinue a particular title, which in the case of the best selling titles could seriously hurt our business.

Our business is subject to sudden changes in the popularity of the products we distribute and to technological changes.

We will be adversely affected by any material decrease in the attractiveness of videogames, or by the availability of equivalent entertainment through the Internet or other channels. The sudden decline in popularity of even one particular video console or game can force us to make a substantial write-down of our inventory of these products.

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Item 6. (a) Exhibits.

31.1 Certificate of Chief Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002.

31.2 Certificate of Chief Financial Officer 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.

32.2 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

In accordance with 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.

November 14, 2006
Alliance Distributors Holding Inc.

By: /s/ Jay Gelman

Jay Gelman
CEO and Chairman of the Board

By: /s/ Stephen Agress

Stephen Agress
Executive Vice President and Chief Financial Officer

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