Alliance Distributors Holding Inc.
Form 10QSB
August 15, 2005

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

FORM 10-QSB

|X| QUARTERLY REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2005

|_| TRANSITION REPORT UNDER 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 small business issuer as specified in its charter)

Delaware	33-0851302
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

15-15 132nd Street
College Point, New York 11356
(Address of Principal Executive Offices)

(718) 747-1500
(Registrant's telephone number, including area code)

Indicate by a 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.

|X| Yes |_| No

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of August 15, 2005 there were 46,417,098 shares of the issuer's Common Stock, par value $.001 per share, issued and outstanding.

Transitional Small Business Disclosure Format |_| Yes |X| No

PART I - FINANCIAL INFORMATION

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Part I - Financial Information
Item 1 - Financial Statements

ALLIANCE DISTRIBUTORS HOLDING INC.
Balance Sheet (Unaudited)
June 30, 2005

ASSETS

Current assets:	
Cash	$ 16,040
Accounts receivable, net of allowance for doubtful accounts of approximately $133,000	3,981,484
Inventory	5,185,565
Due from vendors	74,706
Prepaid expenses and other current assets	136,150
Total current assets	9,393,945
Property and equipment, net	411,957
Other assets	80,300
	$ 9,886,202

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Note payable-bank	$ 4,162,078
Accounts payable	2,956,221
Current portion of long term obligations	26,391
Accrued expenses and other current liabilities	128,220

Total current liabilities	7,272,910
Long term obligations	17,613
Deferred lease obligation	22,553
Commitments and contingencies	
Stockholders' equity:	
Series A Convertible Non-Redeemable Preferred Stock, $.001 par value - Authorized, 8,833,334 shares; issued and outstanding, 403,335 shares	403
Common Stock, $.001 par value - Authorized, 100,000,000 shares; issued and outstanding 46,417,098 shares	46,417
Additional paid-in capital	3,198,251
Accumulated deficit	(671,945)
Total stockholders' equity	2,573,126
	$ 9,886,202

See notes to financial statements.

ALLIANCE DISTRIBUTORS HOLDING INC.
Statements of Operations (Unaudited)
For the three and six months ended June 30, 2005 and 2004

	Three months ended June 30,		Six months en
	2005	2004	2005
Net sales	$ 12,224,803	$ 5,976,377	$ 23,113,638
Cost of goods sold	11,154,292	5,196,597	20,800,790
Gross profit	1,070,511	779,780	2,312,848
Selling, general and administrative expenses	1,274,402	803,096	2,551,804
Income (loss) from operations	(203,891)	(23,316)	(238,956)
Interest expense	126,809	33,453	220,422
Income (loss) before provision for income taxes	(330,700)	(56,769)	(459,378)
Provision for (benefit from) income taxes	5,103	(1,000)	6,103
Net income (loss)	(335,803)	(55,769)	(465,481)
Preferred stock dividends	--	842	--
Net income (loss) available to common shareholders	$ (335,803)	$ (56,611)	$ (465,481)

Net income (loss) available to common shareholders per share - basic & diluted	$ (.01)	$ .00	$ (.01)
Weighted-average common shares outstanding - basic and diluted	46,417,098	24,909,581	46,417,098

See notes to financial statements.

ALLIANCE DISTRIBUTORS HOLDING INC.
Statement of Stockholders' Equity (Unaudited)
For the six months ended June 30, 2005

	Preferred Stock A		Common Stock		Additional Paid In
	Shares	Amount	Shares	Amount	Capital
Balance, January 1, 2005	564,649	$ 564	43,850,740	$ 43,851	$ 3,186,24
Conversion of Preferred Stock A into Common Stock	(161,314)	(161)	2,566,358	2,566	(2,40
Registration costs	--	--	--	--	(16,25
Issuance of stock options to non-employees	--	--	--	--	30,66
Net loss	--	--	--	--	-
Balance, June 30, 2005	403,335	$ 403	46,417,098	$ 46,417	$ 3,198,25

See notes to financial statements.

ALLIANCE DISTRIBUTORS HOLDING INC.
Statements of Cash Flows
For the six months ended June 30, 2005 and 2004 (Unaudited)

	Six months ended June 30,	
	2005	2004
CASH FLOWS USED IN OPERATING ACTIVITIES:		
Net income (loss)	$ (465,481)	$ 83,367

ADJUSTMENTS TO RECONCILE NET INCOME (LOSS) TO		
NET CASH USED IN OPERATING ACTIVITIES:		
Deferred rent	4,956	10,917
Depreciation and amortization	53,079	37,522
Bad debt expense	100,000	--
Stock option compensation expense	30,666	--
Amortization of deferred financing costs	34,000	--
CHANGES IN ASSETS AND LIABILITIES:		
(Increase) decrease in assets		
Accounts receivable	(710,925)	(207,116)
Inventory	(1,317,230)	1,400,991
Due from vendors	(40,458)	(272,262)
Prepaid expenses and other current assets	16,291	(22,118)
Funds on deposit with PPO escrow agent	--	(2,884,171)
Increase (decrease) in liabilities		
Accounts payable	381,579	(2,685,844)
Due to factor	--	1,326,793
Accrued expenses and other current liabilities	14,008	(138,750)
Net cash used in operating activities	(1,899,515)	(3,350,671)
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchase of property and equipment	(55,662)	(13,989)
(Increase) decrease in other assets	(12,500)	698
Net cash used in investing activities	(68,162)	(13,291)
CASH FLOWS PROVIDED BY FINANCING ACTIVITIES:		
Proceeds from note payable - bank	23,635,275	--
Repayments of note payable - bank	(21,840,073)	--
Proceeds from sale of securities	--	4,000,000
Payments for registration and issuance costs	(16,250)	(200,500)
Payments for pre-acquisition liabilities	--	(915,329)
Repayment of long-term obligations	(15,840)	(19,920)
Net cash provided by financing activities	1,763,112	2,864,251
NET DECREASE IN CASH	(204,565)	(499,711)
CASH, beginning of period	220,605	656,853
CASH, end of period	$ 16,040	$ 157,142
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid	$ 182,406	$ 60,608
Income tax paid	$ 2,013	$ 17,635
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Issuance of Series A 6% Preferred Stock to placement agent	$ --	$ 385,000
Liabilities assumed	$ --	$ 1,067,898
Series A 6% Preferred Stock dividend	$ --	$ 842

See notes to financial statements.

ALLIANCE DISTRIBUTORS HOLDING INC.
Notes to Financial Statements (Unaudited)

Note 1 - BASIS OF PRESENTATION, ORGANIZATION AND OTHER MATTERS

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.

On June 17, 2004, the Company (formerly Essential Reality, Inc. "Essential") entered into a Share Exchange Agreement (the "Exchange Agreement") with Jay Gelman, Andre Muller and Francis Vegliante, who were the sole shareholders (the "Shareholders") of AllianceCorner Distributors Inc., a privately held, wholesale distributor incorporated in New York ("AllianceCorner"). AllianceCorner had no prior affiliation with Essential and commenced operations in August 2003. Pursuant to the Exchange Agreement, Essential on June 29, 2004 acquired all the outstanding capital stock of AllianceCorner from the Shareholders in exchange for 1,551,314 Series B Convertible Non Redeemable Preferred Shares ("Series B Preferred Shares"). As a result of the acquisition, the business of Alliance is Essential's only business. The transaction was accounted for as a reverse acquisition as of June 30, 2004 and the pre-acquisition financial statements of AllianceCorner are treated as historical financial statements of the combined companies. As the transaction was accounted for as a reverse acquisition into a public shell, no goodwill has been recorded and the costs incurred have been accounted for as a reduction of additional paid-in capital. As a result of the reverse acquisition: (i) the historical financial statements of Essential for periods prior to the date of the transaction are not presented and (ii) because AllianceCorner is the accounting acquirer, Essential's historical stockholders' equity is not carried forward to the merged company as of June 30, 2004.

The name of AllianceCorner was changed to Alliance Distributors Holding, Inc. ("New York Alliance") in July 2004. Effective November 17, 2004, New York Alliance was merged into Alliance Distributors Holding Inc., a Delaware corporation that was wholly owned by Essential. Effective November 22, 2004, Essential reincorporated in Delaware and changed its name to Alliance Distributors Holding Inc., by way of a merger of Essential into Alliance, which was then a wholly owned Delaware subsidiary of Essential. The Company operates as a single segment.

The accompanying unaudited financial statements have been prepared in accordance 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-QSB should be read in conjunction with the Company's financial statements and notes included in the 2004 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, 2005.

PRIVATE PLACEMENT OFFERING

As part of the Exchange Agreement with AllianceCorner, Essential was required to raise funds to complete the transaction. Essential sold 1,124,767 shares of

Series A 6% Convertible Non Redeemable Preferred Shares (the "Series A Preferred Shares"), through a private placement offering ("PPO"). The PPO resulted in gross proceeds of $4,000,000 and net proceeds to the Company of $3,799,500 less $915,329 for payments of Essential's liabilities. At the same time, substantially all outstanding debt of Essential was extinguished through either conversion into an aggregate of 452,202 Series A Preferred Shares or through cash payments.

Sunrise Securities Corp. ("Sunrise") acted as the placement agent in connection with the PPO and received (a) an $8,500 nonrefundable retainer fee; and (b) a commission consisting of 108,146 shares of Series A Preferred Shares and 5 year warrants due June 29, 2009 to purchase 1,564,096 shares of common stock at an exercise price of $.22. (See Stockholders' Equity section below).

STOCKHOLDERS' EQUITY

Each share of common stock entitles the holder thereof to one vote on each matter that may come before a meeting of the shareholders. Any Series A Preferred Share or Series B Preferred Share entitles the holder to 15.909 votes, and votes as one class with the common stock.

In the Exchange Agreement, the Shareholders agreed to vote their Series B Preferred Shares in favor of an amendment to the Company's Articles of Incorporation that would increase the number of authorized shares of common stock from 50,000,000 to 4,400,000,000 (the "Amendment"), and in favor of a simultaneous reverse split of the common stock on the basis of one share for forty-four shares to 100,000,000 authorized shares (the "Reverse Split"). These actions became effective on November 22, 2004 and all share and per share data included in these financial statements have been retroactively adjusted for the split.

The Series A Preferred Shares were entitled to a dividend in kind, upon conversion, accruing at the rate of 6% per annum from June 29, 2004 until the effectiveness of the Amendment, November 22, 2004. The Company issued 46,200 additional shares of Series A Preferred Shares that converted into 735,000 shares of common stock and recorded a preferred dividend in the amount of $164,531.

The adoption of the Amendment and the Reverse Split resulted in the automatic conversion of each Series A Preferred Share and each Series B Preferred Share into 15.909 shares of common stock. However, Series A Preferred Shares owned by a holder were not to be converted into common stock if and so long as a result of conversion the holder would beneficially own in excess of 4.999% or 9.999% of the issued and outstanding shares, respectively. Any Series A Preferred Shares not converted into the Company's common stock due to the operation of this restriction (the "4.999% Restriction") will no longer be entitled to the 6% dividend referred to above.

From inception through June 30, 2005, the Series A Preferred Shares were converted into 21,127,101 shares of common stock and the Series B Preferred Shares were converted into 24,679,997 shares of common stock, comprising most of the 46,417,098 issued and outstanding shares of common stock.

As of June 30, 2005 there were issued and outstanding 403,335 shares of Series A Preferred Shares convertible into 6,416,693 shares of common stock subject to the 4.999% Restriction.

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. The Company increased its allowance for doubtful accounts by $100,000 during the first quarter of 2005 and maintains a balance of approximately $133,000 at June 30, 2005.

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. Write-downs for slow moving and aged merchandise are provided based on historical experience and current product demand. The Company evaluates the adequacy of the write-downs quarterly. 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.

Income Taxes

AllianceCorner, with the consent of its stockholders, elected to have its income taxed under the provisions of Subchapter S of the Internal Revenue Code and the corresponding provisions of New York State Tax laws. Under the aforementioned provisions, corporate income or loss and any tax credits earned are included in the stockholders' individual federal and state income tax returns. Accordingly, no provision has been made for federal income taxes for the three and six months ended June 30, 2004. AllianceCorner was subject to New York State S corporation taxes and New York City corporate income taxes. The provision for income tax expense (benefit) for the three and six months ended June 30, 2004 comprises state and local taxes.

Effective June 29, 2004, the Company is taxed as a C corporation. The provision for income tax expense for the three and six months ended June 30, 2005 comprises state and local taxes.

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 carryforwards 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.

At December 31, 2004, the Company had federal and state net operating loss carryforwards of approximately $5,000,000, expiring through 2024. The Company has established a full valuation allowance of $2,124,000 at December 31, 2004 due to the uncertainty surrounding the realization of such assets. The Tax Reform Act of 1986 contains provisions that limit the ability to utilize net operating loss carryforwards in the case of certain events including significant changes in ownership interests. The Company has not evaluated whether it has undergone an ownership change pursuant to this act. Based upon the terms of the Exchange Agreement, an ownership change may have occurred. If such ownership changes are found to exist, the net operating loss carryforwards as reported could be significantly limited.

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 weighted average number of common and common equivalent shares outstanding reflects the conversion of Series B Preferred Shares for Common Stock as of January 1, 2004 and of Series A Preferred Shares for Common Stock as of June 29, 2004, computed on a post Reverse Split basis (see Note 1).

Common equivalents for the three and six months ended June 30, 2005 exclude the 500,000 of warrants issued to the Company's lender since their effect would be anti-dilutive. For the three and six months ended June 30, 2005 and 2004 the 403,335 Series A Preferred Shares not eligible for conversion due to the 4.999% Restriction are excluded.

Stock Based Compensation

In January 2005, the Company established a stock option plan. The Company accounts for stock based employee compensation arrangements under the intrinsic value method pursuant to APB Opinion No. 25, "Accounting for Stock Issued to Employees". Under this method, compensation cost is the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. As of June 30, 2005 there were 7,650,000 options issued. The options are ten-year non-qualified options to purchase the Company's common stock, 7,500,000 of the options have an exercise price of $0.325 per share and 150,000 of the options have an exercise price of $.32 per share, vest and become exercisable in 12 equal quarterly installments. Of the total options granted, 1,100,000 options were granted to Jay Gelman, the CEO and Chairman of the Board of Directors of the Company, 100,000 options were granted to Barbara A. Ras, the CFO of the Company, 1,100,000 options were granted to Andre Muller, the President, COO and a director of the Company, and 150,000 options were granted to each of Thomas Vitiello, Steven H. Nathan and Humbert B. Powell, III, each a non-employee director of the Company. The options were granted in reliance on the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended.

Of the total options granted, 250,000 options were granted to a non-employee who provided past services to the Company and 500,000 options were granted to non-employees for future services to be provided over the next three years. The options are ten-year non-qualified options, have an exercise price of $.325 per share, and vest and become exercisable in twelve quarterly installments beginning on April 1, 2005. The fair value of the options-pricing model was calculated with the following weighted-average assumptions used for the grant: risk-free interest rate 4.25%; expected life 6.5 years; expected volatility 55%. During the three and six months ended June 30, 2005, the Company recorded stock-based compensation expense of approximately $3,833 and $30,666, respectively, for these options. 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.

Had compensation costs for the Company's stock option grants to employees been determined based on the fair value at the grant dates for awards under these plans in accordance with SFAS No. 123, the Company's net loss and basic and diluted net loss per share would have been reduced to the pro forma amounts as follows:

	For the Three Months Ended June 30, 2005	For the Six Months Ended June 30, 2005
	(Unaudited)	(Unaudited)
Net loss, as reported	$(335,803)	$(465,481)
Deduct: Total stock-based employee compensation expense determined under fair value based method, net of tax effects	(54,833)	(108,041)
Proforma net loss	$(390,636)	$(573,522)
Net loss per share:		
Basic and diluted - as reported	$ (0.01)	$ (0.01)
Basic and diluted - proforma	$ (0.01)	$ (0.01)

There were no options outstanding at June 30, 2004.

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The fair value of the options-pricing model was calculated with the following weighted-average assumptions used for grants during the six months ended June 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.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment". This statement revises FASB Statement No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123(R) focuses primarily on the accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123(R) requires companies to recognize in the statement of operations the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). This Statement, for small business issuers is effective as of the beginning of the Company's next fiscal year. Accordingly, the Company will adopt SFAS 123(R) in its first quarter of fiscal 2006. The Company is currently evaluating the provisions of SFAS 123(R) and has not yet determined the impact that this Statement will have on its future results of operations or financial position. The impact of this new standard, if it had been in effect, on the net loss and related per share amounts for the three and six months ended June 30, 2005 is disclosed in Stock Based Compensation, above.

In May 2005, the FASB issued SFAS No. 154, "Accounting for Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS No. 154"). SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS No. 154 becomes effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

Note 3 - FINANCING AGREEMENTS

On November 11, 2004, the Company entered into a Financing Agreement ("Agreement") with Rosenthal & Rosenthal, Inc. ("Rosenthal"), which replaced an earlier factor agreement with Rosenthal. Under the Agreement, Rosenthal may in its discretion lend up to $5,000,000 to Alliance based on eligible inventory and receivables. All borrowings are due on demand, are secured by substantially all of the assets of Alliance and are subject to the Company's compliance with certain financial covenants. The Company's CEO and the Company's President signed limited guaranties in respect of borrowings under the Agreement.

The Agreement terminates November 30, 2007 unless terminated by Rosenthal on 30 days' notice. Interest on outstanding borrowings is payable at a variable rate per annum, equal to the prime rate (but not less than 4.75 %) plus 2.00 % (8.25 % as of June 30, 2005). In addition, the Company will pay the lender on each anniversary date an annual fee of 1% of the Maximum Credit of $5,000,000 in the amount of $50,000 which is amortized over one year, and a monthly administrative fee of $1,000. The financing expense for the annual fee recorded for the three and six months ended June 30, 2005 amounted to $12,500 and $25,000, respectively. At June 30, 2005, the loan outstanding amounted to $4,162,078.

In connection with 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 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 will be amortized over the life of the financing agreement of three years. The financing expense recorded for the three and six months ended June 30, 2005 amounted to $4,500 and $9,000, 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. In May 2005, Rosenthal informed the Company that it did not comply with a financial covenant under the Agreement for the fourth quarter of 2004. Rosenthal has provided a waiver for this failure to comply. In addition, for the first and second quarter of 2005, the Company did not comply with certain financial covenants for which Rosenthal has also provided waivers.

The Company and Rosenthal are currently renegotiating the terms and covenants of the Agreement and the Company anticipates that such renegotiation will be successful. Subject to the execution of this revised agreement, the Company believes that it will have sufficient liquidity for the next twelve months and the foreseeable future. However, the Company would have to scale down its operations if it is unsuccessful in renegotiating the borrowing base and financial covenants. Furthermore, the Company would be materially and adversely affected if Rosenthal demands payment of these borrowings under the Agreement and the Company is unable to refinance these borrowings.

Note 4 - LITIGATION

On August 19, 2004 a complaint was filed by Radio Wave LLC ("Plaintiff"), in the Supreme Court of the State of New York, County of New York, against Essential Reality, LLC, Essential 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. Plaintiff seeks to recover $150,416 for the period up to August 31, 2004, plus additional amounts to be determined by the Court for the period subsequent to August 31, 2004. Plaintiff also seeks to recover $50,000 in expenses and attorney fees plus additional amounts to be determined by the Court. The Company believes that the suit is without merit and intends to vigorously defend its position.

Note 5 - SUBSEQUENT EVENT

On July 21, 2005, the Company and Abrams/Gentile Entertainment Inc. ("Age") entered into an operating agreement ("Agreement") of 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 agreed to pay Age a $4,000 monthly retainer fee on the first day of each month commencing August 2005, provided, that no fee is payable for any month beginning with January 2006 upon a determination that no products are then proceeding towards completion at a proper pace. The Company owns 65% of Alliance Age LLC. Alliance Age LLC will be included in future periods as a majority subsidiary of the Company and included in subsequent financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN 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, 2004.

OVERVIEW

See "Note 1", for description of a transaction whereby AllianceCorner Distributors Inc. ("AllianceCorner") became a New York wholly-owned subsidiary of Essential. The name of AllianceCorner was changed to Alliance Distributors Holding, Inc. ("New York Alliance") in July 2004. Effective November 17, 2004, New York Alliance was merged into Alliance Distributors Holding Inc., a Delaware corporation that was wholly owned by Essential. Effective November 22, 2004, Essential reincorporated in Delaware and changed its name to Alliance Distributors Holding Inc. ("Alliance" or the "Company"), by way of a merger of Essential into Alliance, which was then a wholly owned Delaware subsidiary of Essential. The business of AllianceCorner became our only business. Since the former stockholders of AllianceCorner acquired a majority of our voting interests, the transaction was treated as a reverse acquisition, with AllianceCorner treated as the acquirer for accounting purposes. Accordingly, the pre-acquisition financial statements of AllianceCorner are our historical financial statements. At the time of the acquisition, Essential had no continuing operations and its historical results would not be meaningful if combined with the historical results of AllianceCorner.

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 the Company's accounting policies require the application of significant judgment by management 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 - The Company recognizes sales upon shipment of products to customers as title and risk of loss pass upon shipment and collectibility is reasonably assured. Provisions for estimated uncollectible discounts and rebates to customers, estimated returns and allowances and other adjustments are provided for in the same period the related sales are recorded. While such amounts have been within expectations and the provisions established, the Company cannot guarantee that it 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. 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 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. 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. The Company increased its allowance for doubtful accounts by $100,000 during the first quarter of 2005 and maintains a balance of approximately $133,000 at June 30, 2005.

Inventories - Inventory is stated at the lower of cost or market, cost being determined on the average cost basis. Write-downs for slow moving and aged merchandise are provided based on historical experience and current product demand. The Company evaluates the adequacy of the write-downs quarterly. 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.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment". This statement revises FASB Statement No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123(R) focuses primarily on the accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123(R) requires companies to recognize in the statement of operations the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). This Statement, for small business issuers is effective as of the beginning of the Company's next fiscal year. Accordingly, the Company will adopt SFAS 123(R) in its first quarter of fiscal 2006. The Company is currently evaluating the provisions of SFAS 123(R) and has not yet determined the impact that this Statement will have on its future results of operations or financial position. The impact of this new standard, if it had been in effect, on the net loss and related per share amounts of our fiscal quarter ended June 30, 2005 is disclosed in Note 2 of the financial statements.

In May 2005, the FASB issued SFAS No. 154, "Accounting for Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS No. 154"). SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS No. 154 becomes effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

RESULTS OF OPERATIONS

The following tables show each specified item as a dollar amount and as a percentage of net sales for the three and six months ended June 30, 2005 and 2004, respectively, and should be read in conjunction with the financial statements included elsewhere in this Quarterly Report on Form 10-QSB:

Three Months Ended June 30, 2005 compared to Three Months Ended June 30, 2004

	Three months Ended June 30, 2005 (Thousands)		Three months Ended June 30, 2004 (Thousands)	
Net sales	$ 12,225	100.0%	$ 5,976	100.0%
Cost of goods sold	11,154	91.2%	5,196	87.0%
Gross profit	1,071	8.8%	780	13.0%
Selling, general and administrative expenses	1,275	10.4%	803	13.4%
Loss from operations	(204)	(1.6%)	(23)	(.4)%
Interest expense	127	1.1%	33	.6%
Loss before income taxes	(331)	(2.7)%	(56)	(1.0)%
Income taxes	5	.0%	(1)	.0%
Net loss	$ (336)	(2.7)%	$ (55)	(1.0)%

Net sales increased by $6,248,426, or 104.6%, from $5,976,377 for the three months ended June 30, 2004 to $12,224,803 for the three months ended June 30, 2005. 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.

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Cost of goods sold increased by $5,957,695, or 114.6%, from $5,196,597 for the three months ended June 30, 2004 to $11,154,292 for the three months ended June 30, 2005. The increase was consistent with revenue growth. Gross profit as a percentage of net sales decreased to 8.8% for the three months ended June 30, 2005 from 13.0% for the three months ended June 30, 2004. This decrease was primarily due to the Company's strategy to grow the customer base and increase revenues during the second quarter, which historically has been the weakest period, by introducing incentive pricing programs to new and key customers. 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 $265,270 and $225,702 for the quarter ended June 30, 2005 and 2004, respectively.

Selling, general and administrative expenses increased by $471,306, or 58.7%, from $803,096 for the three months ended June 30, 2004 to $1,274,402 for the three months ended June 30, 2005. The increase was primarily due to the Company's increase in salaries and related payroll taxes of $175,052, professional fees associated with the Company's expanded operations of $110,936, advertising and marketing expenses of $62,288 and insurance premiums of $44,999. Selling, general and administrative expenses as a percentage of net sales decreased to 10.4% for the three months ended June 30, 2005 from 13.4% for the three months ended June 30, 2004. For the three months ended June 30, 2005, selling, general and administrative expenses were comprised of the following:

$206,018 in selling expenses, $265,270 in distribution costs and $803,114 in general and administrative expenses. For the three months ended June 30, 2004, selling, general and administrative expenses were comprised of the following: $125,597 in selling expenses, $225,702 in distribution costs and $451,797 in general and administrative expenses.

Interest expense increased by $93,356, or 279.0%, from $33,453 for the three months ended June 30, 2004 to $126,809 for the three months ended June 30, 2005. The increase was primarily due to increased borrowings as well as higher interest rates on bank borrowings during the second quarter of 2005. The increased borrowing levels were the result of increased sales volume that required higher inventory levels and increased accounts receivable.

Six Months Ended June 30, 2005 compared to Six Months Ended June 30, 2004

	Six months Ended June 30, 2005 (Thousands)		Six months Ended June 30, 2004 (Thousands)	
Net sales	$ 23,114	100.0%	$ 13,276	100.0%
Cost of goods sold	20,801	90.0%	11,397	85.8%
Gross profit	2,313	10.0%	1,879	14.2%
Selling, general and administrative expenses	2,552	11.0%	1,724	13.0%
Income (loss) from operations	(239)	(1.0)%	155	1.2%
Interest expense	220	1.0%	61	.5%
Income (loss) before income taxes	(459)	(2.0)%	94	.7%
Income taxes	6	.0%	11	.1%
Net income (loss)	$ (465)	(2.0)%	$ 83	.6%

Net sales increased by $9,837,620, or 74.1%, from $13,276,018 for the six months ended June 30, 2004 to $23,113,638 for the six months ended June 30, 2005. 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 $9,403,572, or 82.5%, from $11,397,218 for the six months ended June 30, 2004 to $20,800,790 for the six months ended June 30, 2005. The increase was consistent with revenue growth. Gross profit as a percentage of net sales decreased to 10.0% for the six months ended June 30, 2005 from 14.2% for the six months ended June 30, 2004. This decrease was primarily due to the Company's strategy to grow the customer base and increase revenues by introducing incentive pricing programs to new and key customers. 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

$518,580 and $504,903 for the six months ended June 30, 2005 and 2004, respectively.

Selling, general and administrative expenses increased by $828,146, or 48.0%, from $1,723,658 for the six months ended June 30, 2004 to $2,551,804 for the six months ended June 30, 2005. The increase was primarily due to the Company's increase in salaries and related payroll taxes of $245,604, professional fees associated with the Company's expanded operations of $173,699, allowance for doubtful accounts of $100,000, advertising and marketing expenses of $85,178, insurance premiums of $95,772 and stock option compensation expense of $30,666

as a result of 750,000 options that were granted to non-employees who provide services to the Company. Selling, general and administrative expenses as a percentage of net sales decreased to 11.0% for the six months ended June 30, 2005 from 13.0% for the six months ended June 30, 2004. For the six months ended June 30, 2005, selling, general and administrative expenses were comprised of the following: $370,777 in selling expenses, $518,580 in distribution costs and $1,662,447 in general and administrative expenses. For the six months ended June 30, 2004, selling, general and administrative expenses were comprised of the following: $257,887 in selling expenses, $504,903 in distribution costs and $960,868 in general and administrative expenses.

Interest expense increased by $159,814, or 263.7%, from $60,608 for the six months ended June 30, 2004 to $220,422 for the six months ended June 30, 2005. The increase was primarily due to increased borrowings as well as higher interest rates on bank borrowings during the first and second quarter of 2005. 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 six months ended June 30, 2005 net cash used in operating activities was $1,899,515. Net cash used in operations for the six months ended June 30, 2005 consisted of a net loss of $465,481 and included the following changes in operating assets and liabilities: an increase in accounts receivable of $710,925, and an increase in inventory of $1,317,230. These increases were the result of increased sales volume.

Net cash used in investing activities for the six months ended June 30, 2005 was $68,162, which was primarily used for the purchase of equipment.

Net cash provided by financing activities for the six months ended June 30, 2005 was $1,763,112 which primarily consisted of net proceeds on our note payable to bank of $1,795,202.

For the six months ended June 30, 2004 net cash used in operating activities was $3,350,671. Net cash used in operations for the six months ended June 30, 2004 consisted of net income of $83,367 and included the following changes in operating assets and liabilities: an increase in funds on deposit with PPO escrow agent of $2,884,171, decrease in inventory of $1,400,991, decrease in accounts payable of $2,685,844 and increase in due to factor of $1,326,793, due to advances taken during the period.

Net cash used in investing activities for six months ended June 30, 2004 was $13,291, which was primarily used for the purchase of equipment.

Net cash provided by financing activities for the six months ended June 30, 2004 was $2,864,251, which consisted of gross proceeds of $4,000,000 from the PPO and payments of issuance costs and Essential pre-acquisition liabilities of $200,500 and $915,329, respectively.

On November 11, 2004, the Company, entered into a Financing Agreement ("Agreement") with Rosenthal & Rosenthal Inc. ("Rosenthal"). Under the Agreement, Rosenthal may in its discretion lend up to $5 million to the Company 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 Agreement terminates November 30, 2007 unless terminated sooner by Rosenthal on 30 days' notice. Interest on outstanding borrowings is payable at a variable rate per annum, equal to the prime rate (but not less than 4.75 percent) plus 2.00 percent (8.25 percent as June 30, 2005). The Company's CEO and the Company's President signed limited guaranties in respect of borrowings under the Agreement.

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. In May 2005, Rosenthal informed the Company that it did not comply with a financial covenant under the Agreement for the fourth quarter of 2004. Rosenthal has provided a waiver for this failure to comply. In addition, for the first and second quarter of 2005, the Company did not comply with certain financial covenants for which Rosenthal has also provided waivers.

The Company and Rosenthal are currently renegotiating the terms and covenants of the Agreement and the Company anticipates that such renegotiation will be successful. Subject to the execution of this revised agreement, the Company believes that it will have sufficient liquidity for the next twelve months and the foreseeable future. However, the Company would have to scale down its operations if it is unsuccessful in renegotiating the borrowing base and financial covenants. Furthermore, the Company would be materially and adversely affected if Rosenthal demands payment of these borrowings under the Agreement and the Company is unable to refinance these borrowings.

ITEM 3. 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 Principal 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 June 30, 2005 ("Evaluation Date"). Based on such evaluation, our Chief Executive Officer and Principal 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 Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Additionally in 2005, the Company is implementing periodic observation of inventory through the use of computerized equipment and will conduct periodic reconciliation to the perpetual inventory file. These changes will have the effect of ensuring that account reconciliation operational controls are operating as designed and will reduce the probability of human error. The Company introduced these controls after learning of the errors described in Note 12 of the Financial Statements in the Annual Report on Form 10-KSB.

Other than the changes noted above, there have been no changes in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the Company's fiscal quarter that has materially affected, or is reasonable likely to materially affect, the Company's internal control over financial reporting.

PART 2. OTHER INFORMATION

Item numbers 1, 2, 3, 4 and 5 are not applicable and have been omitted.

ITEM 6. EXHIBITS.

Exhibits.

EXHIBIT INDEX

NUMBER	DESCRIPTION
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1	Operating Agreement of Alliance Age LLC between Alliance Distributors Holding Inc. and Abrams/Gentile Entertainment Inc. dated July 21, 2005.

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.

August 15, 2005
Alliance Distributors Holding Inc.

By: /s/ Jay Gelman

Jay Gelman
CEO and Chairman of the Board

By: /s/ Barbara A. Ras

Barbara A. Ras
Chief Financial Officer (Principal Financial and Accounting Officer)