NEXT INC/TN
Form 10QSB
October 08, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

(Mark One)

[X]

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

For the Quarterly Period Ended August 31, 2004

OR

[ ]

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

Commission File Number: 0-25247

NEXT, INC.

(Exact name of small business issuer as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**95-4675095** (I.R.S. Employer Identification No.)

7625 Hamilton Park Drive, Suite 12

Chattanooga, Tennessee 37421

(Address and zip code of principal executive offices)

Registrant s telephone number, including area code: **(423) 296-8213**

Check whether the issuer (1) filed all reports required by Section 13 or 15(d) of the Exchange Act during the past 12 months (as for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

The number of shares of Registrant s common stock, par value $.001 per share, issued and outstanding as of October 8, 2004 was 16,126,286.

Transitional Small Business Disclosure Format (Check one): Yes [ ] No [X]

NEXT, INC.

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Part I FINANCIAL INFORMATION

Item 1.

Financial Statements

NEXT, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

	August 31, 2004 (unaudited)
Assets	
Current assets:	
Cash	$ 202,888
Accounts receivable, net	5,919,769
Inventories	7,252,883
Prepaid expenses and other current assets	798,235
Deferred taxes, current	642,396

Total current assets	14,816,171
Property, plant and equipment, net	2,286,211
Goodwill	3,685,850
Other assets, net	910,822
Total Assets	$ 21,699,054
Liabilities and Stockholders Equity	
Current liabilities:	
Accounts payable	$ 3,756,472
Accrued expenses and other current liabilities	1,797,374
Short-term debt and current maturities	247,116
Total current liabilities	5,800,962
Long-term debt, less current maturities	9,317,023
	281,802
Deferred taxes	
Other non-current liabilities	371,000
Total liabilities	15,770,787
Commitments and contingencies	--

Stockholders equity		5,928,267
Total Liabilities and Stockholders Equity	$	21,699,054

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

NEXT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

		Three Months Ended		
		August 31, 2003		August 31, 2004
		(unaudited)		(unaudited)
Net sales	$	4,608,648	$	6,059,394

Cost of sales	3,198,099	4,259,502
Gross profit	1,410,549	1,799,892
General administrative and selling expenses	1,196,414	1,564,461
Operating income	214,135	235,431
Interest	(109,806)	(111,299)
Other income (expense)	27,846	24,197
Income before income taxes	132,175	148,329
Provision for income taxes	52,055	38,656
Net Income	80,120	109,673
Net Income per share, basic	$ .01	$ .01
Net Income per share, diluted	$ .01	$ .01
Weighted average shares outstanding, basic	12,502,523	14,686,526
Weighted average shares outstanding, diluted	12,502,523	15,709,001

	Nine Months Ended	
	August 31, 2003 (unaudited)	August 31, 2004 (unaudited)
Net sales	$ 13,445,902	$ 13,780,929
Cost of sales	9,406,926	9,534,909
Gross profit	4,038,976	4,246,020
General administrative and selling expenses	3,407,591	3,975,190
Operating income	631,385	270,830
Interest	(336,458)	(342,634)
Other income (expense)	22,829	(588,053)
Income (loss) before income taxes	317,756	(659,857)
Provision (Benefit) for income taxes	127,375	(341,191)
Net Income (loss)	190,381	(318,666)
Net Income (loss) per share, basic	$ .02	$ (.02)
Net Income (loss) per share, diluted	$ .02	$ (.02)

Weighted average shares outstanding, basic	11,632,036	14,358,797
Weighted average shares outstanding, diluted	11,632,036	15,381,272

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

NEXT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	August 31, 2003 (unaudited)	August 31, 2004 (unaudited)
Cash flows from operating activities:		
Net income (loss)	$ 190,381	$ (318,666)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	283,055	367,385
Noncash compensation	32,850	65,801
Noncash fees	78,933	309,109
Bad debt expense	46,474	(2,082)
Deferred taxes	127,375	(341,191)
Changes in operating assets and liabilities:		
Accounts receivable	(53,134)	(1,724,148)
Inventories	(907,219)	(2,244,387)

Prepaid expenses	(150,351)	(164,869)
Other current assets	(174,522)	(136,655)
Accounts payable	(273,664)	1,322,739
Accrued expenses and other liabilities	(260,670)	1,013,326
Other non-current assets	1,948	--
Total adjustments	(1,248,925)	(1,534,972)
Net cash used in operating activities	(1,058,544)	(1,853,638)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(397,221)	(413,548)
Cash received from proceed on sale of asset	--	9,250
Cash paid for acquisition cost	(100,000)	--
Cash received from acquisition	25,914	--
Cash paid for intangible assets	(115,774)	(194,639)
Net cash used in investing activities	(587,081)	(598,937)
Cash flows from financing activities:		
Revolving credit facility, net	945,173	419,792

Proceeds from loans and notes payable, bank	737,504	1,092,820
Repayments of long terms debt, loans and notes payable, bank	(591,688)	(742,263)
Cash paid for investment transaction	--	(190,567)
Issuance of preferred stock, net	--	1,471,501
Issuance of common stock	545,000	7,750
Net cash provided by financing activities	1,635,989	2,059,033
Net decrease in cash	(9,636)	(393,542)
Cash, beginning of period	454,340	596,430
Cash, end of period	$ 444,707	$ 202,888
Supplemental Information:		
Cash paid during the period for interest	$ 328,828	$ 354,086
Cash paid during the period for income taxes	$ 4,823	$ --
Non-Cash Investing and Financing Activities:		
Equity securities issued in connection with the acquisition of:		
CMJ Ventures, Inc.	$ 118,732	$ --

Lil Fan, Inc.	$	227,500	$	--
Equity securities issued in payment of notes payable	$	7,600	$	90,000
Equity securities issued for services	$	245,500	$	225,584
Refinancing of debt	$	2,574,255	$	4,602,010
Conversion of account receivable and prepaid to note receivable	$	350,000	$	--

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

NEXT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1.

Organization and Operations of Company

Next, Inc., (the Company) is the parent company of (i) Next Marketing, Inc., (Next Marketing), (ii) Blue Sky Graphics, Inc., (Blue Sky), (iii) CMJ Ventures, Inc. (CMJ), and (iv) Lil Fan, Inc. (Lil Fan). The Company is creative and innovative sales and marketing organization that designs, develops, markets and distributes licensed and branded promotional products and imprinted sportswear primarily through key licensing agreements and the Company s own proprietary designs.

2.

Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements contained herein have been prepared in accordance with generally accepted accounting principles for interim financial statements, the instructions to Form 10-QSB and Item 310 of Regulation S-B. Accordingly, these financial statements do not include all the information and footnotes required by generally accepted accounting principles for annual financial statements. In addition, certain comparative figures presented have been reclassified to conform the prior year s data to the Company s current financial statements. In the opinion of management, the accompanying condensed consolidated financial statements contain all the adjustments necessary (consisting only of normal recurring accruals) to fairly present the financial position of the Company at August 31, 2004, and its results of operations and cash flows for the three and nine months ended August 31, 2003 and August 31, 2004. Operating results for the three and nine months ended August 31, 2004, are not necessarily indicative of the results that may be expected for the fiscal year ending November 30, 2004.

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company balances and transactions have been eliminated.

Customer Base & Credit Concentration

The Company, over the last three years, has developed a large, diverse, and distinguished customer base of traditional retailers, ranging from national as well as large regional chains, specialty retailers, corporate accounts, college bookstores, motor sports, souvenir and gift shops, and golf shops. This expansion has been achieved through the acquisition of CMJ and Lil Fan and their respective substantial customer base, the introduction of additional major product lines and distribution channels, such as the Motor Sports Division, which sells to a national auto dealers market consisting of approximately 9,000 dealers, of which, the Company has sold to approximately 1,100 dealers thus far, as well as expansion of its traditional national retail merchant customer base. As a result of the expansion, the Company has lessened its dependence on any one large customer or distribution channel. During the nine months ended August 31, 2004, the Company s sales to six customers comprised 61.5% of total sales, one of which was a not a customer in the six months ended August 31, 2003. During the nine months ended August 31, 2003, the Company s sales to five customers comprised 65.1% of total sales, one of which represented a one-time order related to the Iraq war of approximately $2,500,000. The Company s management believes that its credit risk exposure, based on current information available on the financial strength of its customers and previously recorded reserves, is limited. Such estimates could change in the future.

New Pronouncements

SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets"; SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections"; SFAS No. 141, Business Combinations, SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" and SFAS No.148, "Accounting for Stock Based Compensation," FASB Interpretation No. 45, Guarantor s Accounting and Disclosure requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others , FASB Interpretation No. 46, Consolidation for Variable Interest Entities all became effective for the Company during 2002. The provisions and interpretations of these pronouncements, that are applicable to the Company, had no material effect on the Company's financial statements.

SFAS No. 142, "Goodwill and Other Intangible Assets" became effective for the Company during 2002. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairment of goodwill. SFAS 142 also requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The provisions of these interpretations that are applicable to the Company were implemented on a prospective basis as of January 1, 2002, which had no material effect on the Company's financial statements.

3.

Inventories

Inventory is valued at the lower of cost or market. Cost is determined by the first-in, first-out method, and market represents the lower of replacement cost or net realizable value. Inventories as of August 31, 2004, consisted of the following:

Raw materials	$ 6,177,372
Work in process	317,044
Finished goods	758,467
	$ 7,252,883

4.

Deferred and Income Taxes

Income taxes have been computed in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109). This standard requires, among other things, recognition of future tax expenses or benefits, measured using enacted tax rates, attributable to taxable or deductible temporary differences between financial statements and income tax reporting bases of assets and liabilities.

The ultimate realization of deferred tax assets is dependent upon the attainment of forecasted results of operations. Management has taken these and other factors into consideration in recording the deferred tax estimate. The tax effects of temporary differences that give rise to significant portions of the deferred tax asset and liabilities at August 31, 2004, are as follows:

Current asset:		
Accounts receivable reserves	$ 7,348	
Net operating loss carryforwards		635,048

Current deferred tax asset	$ 642,396

Non-current liability:	
Goodwill and other intangibles	$ 2,475
Adoption of tax depreciation method	279,327
Long-term deferred tax liability	$ 281,802

5.

Short-Term and Long-Term Debt

Short-term and long-term debt at August 31, 2004 consisted of the following:

	Short Term	Long Term
Revolving credit facility	$ -	$ 5,872,905
Notes payable	219,030	3,436,514
Capital lease obligations	28,086	7,604
Total	$ 247,116	$ 9,317,023

Various assets collateralize all of the Company s debt and varying amounts guaranteed by its principal stockholders.

On April 15, 2004, the Company entered into a credit agreement with National City Bank for an $8,000,000 revolving credit facility agreement, which matures on April 1, 2006. The Company may draw up to the sum of 85% of eligible accounts receivable, as defined, and 60% of eligible raw materials and finished goods inventory. In addition, the agreement provides for monthly payments of interest at a nationally published prime rate plus .25% (4.75% was the published rate at August 31, 2004) and the Company must comply with certain financial and other covenants. Accounts receivable, inventory, and certain personal assets and personal guarantees of the Company s CEO and CFO collateralize borrowings under the facility. The new credit agreement replaces the former lender, LaSalle Business Credit, LLC and increases the Company s borrowing base formula, reduces expenses, and extends the maturity date by one year.

On January 20, 2004, the Company entered into a subordinated loan agreement with Next Investors, LLC for $400,000. The purpose of this loan was to provide working capital to be repaid out of a future equity infusion. The loan has a 4% interest rate and a maturity date of January 2006.

6.

Stockholders Equity

Stockholders Equity was comprised of the following:

		At August 31, 2004 (unaudited)
Preferred stock, $.001 par value; 10,000,000 shares authorized, 1,750 shares issued and outstanding	$	2
Common stock, $.001 par value; 50,000,000 shares authorized, 14,777,546 shares issued and outstanding		14,778
Additional paid in capital		4,710,919
Retained earnings		1,245,349
Unearned compensation		(42,781)
Total stockholders equity	$	5,928,267

The Company assumed the 2001 Next Stock Option Plan (the Next Plan) and all pre-existing options granted there under. The issue date of the Next Plan was December 19, 2002 and the Company assumed it on February 1, 2003. Pursuant to the terms of the Next Plan and the assumption agreement, any options to acquire shares of Next s common stock previously granted under the plan shall be replaced with options to acquire shares of the Company s common stock. 498,000 options have been granted under the Plan, with each option vesting on the two-year anniversary of the grant date. The options expire on December 19, 2008. In 2003, the Company issued 160,000 employee options; 60,000 issued at $0.20, which vested December 19, 2003; 25,000 at $0.50 vest June 5, 2005; and 75,000 at $1.01 vest on June 19, 2005. The 160,000 options granted in 2003 all have five-year expirations from the date of the grant and are subject to forfeiture should the grantee fail to be employed by the Company on the vesting date. In 2004 the Company has issued 286,500 employee options at $1.07, which vest on December 15, 2005. These options all have five-year expirations from the date of grant and subject to forfeiture should the grantee fail to be employed by the Company on the vesting date. The options issued in 2003 and 2004 were all issued at market value and as such no expense was recorded. As of August 31, 2004, 608,000 options were vested of the total 944,500 options granted, and 310,000 options have been exercised. No options were vested as of August 31, 2003.

On March 11, 2004, the Company entered into an Equity Line of Credit (Equity Line) agreement with Dutchess Private Equities Fund, L. P. (Dutchess). The Equity Line permits the Company to put up to $10.0 million in shares of our common stock to Dutchess. The Company has not drawn any funds on the Equity Line and terminated the agreement on August 2, 2004.

On April 8, 2004, the Company issued, pursuant to a Securities Purchase Agreement 1,750 shares of Series A Convertible Preferred Stock to GCA Strategic Investment Fund Limited. The Company received net proceeds of $1,662,500, which was utilized for working capital and debt reduction. The Company has registered these shares but will receive no proceeds related to the sale of the securities. The Company also issued a Preferred Stock Warrant to purchase 358,000 shares of common stock at $1.88, which expires April 8, 2009. The Company has also received a commitment letter from Global Capital Advisors, LLC for an additional $1,250,000 under the same terms and conditions discussed above at the Company s option for a one-year period, which will expire on March 31, 2005.

On July 9, 2003, the Company issued, pursuant to a Securities Purchase Agreement with certain substantive investors, 750,000 shares of common stock at a price of $.80 per share and warrants to purchase 375,000 shares of common stock at a price of $1.125 per share for a period of five years from the closing date. Also, the Company issued 100,000 shares for investment banking services associated with the Securities Purchase Agreement. The net result of the above transaction was an increase in Stockholders Equity of $523,573, net of fees and expenses.

The significant shareholders of the Company, representing approximately 43.7% of total shares outstanding, terminated lock-up agreements whereby the shares owned by them were subject to a lockup through at least May 1, 2004. However, the terms of the GCA Strategic Investment Fund Securities Purchase Agreement dated April 8, 2004 limits the sale by all Executive Officers of the Company of no more than 75,000 shares per year.

7.

Income (Loss) Per Share

The Company accounts for earnings per share (EPS) in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, Loss Per Share . SFAS 128 requires the presentation of basic and fully diluted EPS. Basic and diluted EPS for the three and nine months ended August 31, 2003 and August 31, 2004 were calculated on the basis of the weighted average number of common shares outstanding during the three and nine-month periods, divided by the income available to common stockholders.

Item 2.

Management s Discussion and Analysis or Plan of Operation.

You should read this section together with our condensed consolidated financial statements and related notes thereto included elsewhere in this report. In addition to the historical information contained herein, this report contains forward-looking statements that involve risks and uncertainties. Forward-looking statements are not based on historical information but relate to future operations, strategies, financial results or other developments. Forward-looking statements are necessarily based upon estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and many of which, with respect to future business decisions, are subject to change. Certain statements contained in this Form 10-QSB, including, without limitation, statements containing the words believe , anticipate, estimate , expect , are of the opinion that and words of similar import, constitute forward-looking statements. You should not place any undue reliance on these forward-looking statements.

You should be aware that our actual growth and results could differ materially from those contained in the forward-looking statements due to a number of factors, which include, but are not limited to the following: the risks and uncertainties set forth below; economic and business conditions specific to the promotional products and imprinted sportswear industry; competition and the pricing and mix of products offered by us and our competitors; style changes and product acceptance; relations with and performance of suppliers; our ability to control costs and expenses; carry out successful designs and effectively communicate with our customers and to penetrate their chosen distribution channels; access to capital; foreign currency risks; risks associated with our entry into new markets or distribution channels; risks related to the timely performance of third parties, such as shipping companies, including risks of strikes or labor disputes involving these third parties; maintaining satisfactory relationships with our banking partners; political and trade relations; the overall level of consumer spending; global economic conditions and additional threatened terrorist attacks and responses thereto, including war. There may be other factors not mentioned above or included elsewhere in this report that may cause actual results to differ materially from any forward-looking information. You should not place undue reliance on these forward-looking statements. We assume no obligation to update any forward-looking statements as a result of new information, future events or developments, except as required by applicable securities laws.

Introduction

As noted elsewhere in this report, the Company s principal customers are large national and regional retailers. In order to maintain its relationship with these customers, enhance revenues from them and enable them to improve their revenues and margins, the Company must work closely with these customers to ensure they receive the Company s products expeditiously and economically. The Company works diligently to maintain what Management calls supply chain excellence a way for the Company to provide value added services to its customers.

In servicing its customers, the Company faces competition from numerous other providers of licensed promotional products. Many of these competitors are larger and better capitalized than the Company. Additionally, if the Company is to continue to grow its business by adding additional products and by making strategic acquisitions, it will require additional capital. Therefore, Management may enter into negotiations with sources of equity in an effort to furnish additional capital.

In assessing the Company s performance, Management focuses on (a) increasing revenues primarily through enhancing it s licensing programs and (b) protecting such revenues by diversifying its customer bases regionally and demographically. In order to enhance profitability, Management monitors and seeks to improve gross margins primarily by internal cost controls and through international purchases of raw materials. Management also strives to reduce fixed costs as a percentage of sales, improve inventory turnover and reduce receivables measured by day s sales outstanding, all in an effort to improve profitability and cash flow.

Overview

The Company is a creative and innovative sales and marketing organization that designs, develops, markets, and distributes licensed and branded promotional products and imprinted sportswear primarily through key licensing agreements and the Company s own proprietary designs. Management believes that there are substantial growth opportunities in the promotional products and imprinted sportswear industries. Management believes that the Company is well positioned to take advantage of such growth opportunities. Management believes that the Company has an excellent reputation in the marketplace as a result of its ability to provide quality products and services, on-time delivery, at competitive prices. In recent years, licensed imprinted sportswear has become very popular. Licensing agreements are available for branded products and services, amateur and professional sports teams, and many other promotional areas. To maximize its potential, the Company has, over the last two years, significantly expanded its license program to include the following:

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Licensing agreements to distribute its **Campus Traditions USA™** line for major colleges and universities in the U.S.;

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Licensing agreements with **Chevy®**, **Pontiac ®**,