Flooring Zone Inc
Form 10KSB
August 09, 2006

U.S. Securities and Exchange Commission
Washington, D.C. 20549

Form 10-KSB

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1933

For the fiscal year ended December 31, 2005

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to ______________

Commission File Number 333-119234

THE FLOORING ZONE, INC.
(Name of Small Business Issuer in its charter)

NEVADA	20-0019425
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3219 Glynn Avenue, Brunswick, Georgia	31520
(Address of principal executive Offices)	(Zip Code)

Issuer's telephone number: (912) 264-0505

Securities registered pursuant to section 12(b) of the Exchange Act: None

Securities registered pursuant to section 12(g) of the Exchange Act: None

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this form 10-KSB or any amendment to this Form 10-KSB. [X]

The issuer's revenue for its most recent fiscal year was: $3,043,852.

The aggregate market value of the issuer's voting stock held as of June 20, 2006 by non-affiliates of the issuer, based on the price at which the shares were sold, was approximately: $721,725.

As of June 20, 2006, the issuer had 19,569,750 shares of its $0.001 par value common stock outstanding.

Transitional Small Business Disclosure Format. Yes [ ] No [X]

Documents incorporated by reference: none

TABLE OF CONTENTS

PART I

ITEM 1. DESCRIPTION OF BUSINESS

ITEM 2. DESCRIPTION OF PROPERTY

ITEM 3. LEGAL PROCEEDINGS

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

ITEM 7. FINANCIAL STATEMENTS

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

ITEM 8A. CONTROLS AND PROCEDURES

PART III

ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS, PROMOTERS, AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

ITEM 10. EXECUTIVE COMPENSATION

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

PART IV

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

SIGNATURES

2

PART I

FORWARD

This Form 10-KSB contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. For this purpose any statements contained in this Form 10-KSB that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, words such as "may," "hope," "will," "expect," "believe," "anticipate," "estimate" or "continue" or comparable terminology are intended to identify forward-looking statements. These statements by their nature involve substantial risks and uncertainty, and actual results may differ materially depending on a variety of factors, many of which are not within the Company's control. These factors include but are not limited to economic conditions generally and in the industries in which the Company and its customers participate; competition within the Company's industry, including competition from much larger competitors; technological advances which could render the Company's products less competitive or obsolete; failure by the Company to successfully develop new products or to anticipate current or prospective customers' product needs; price increase or supply limitations for components purchased by the Company for use in its products; and delays, reductions, or cancellations of orders previously placed with the Company.

ITEM 1. DESCRIPTION OF BUSINESS

We filed our Articles of Incorporation on May 5, 2003. On May 13, 2003, pursuant to a Share Exchange Agreement, we acquired all of the outstanding common stock of The Flooring Zone of Georgia, Inc., in exchange for 38,125,000 shares of our common stock. The Flooring Zone of Georgia, Inc., was founded by our president in 2000, and had been operating in the retail floorcovering industry since its inception. We currently own and operate two retail flooring stores located in the southeast United States, one in southern Georgia and one in northern Florida. We have also licensed our name to a floorcovering retailer with a single store in northern Florida, for which we receive a license fee. Our executive offices are located in our Georgia store located at 3219 Glynn Avenue, Brunswick, Georgia 31520. Our telephone number at that location is (912) 264-0505. Our website is located at www.theflooringzone.com.

Retail Floorcovering Industry

The North American retail floorcovering industry is highly fragmented with approximately 15,000 individual floorcovering retail dealers operating 25,000 locations in North America according to FLOOR COVERING WEEKLY, a leading floorcovering industry publication. Our management believes that no single retailer accounts for more than a 5% market share of total annual industry revenues. The industry is characterized by a large number of small local and regional companies and a small number of national chains, such as The Home Depot, and organizations such as Carpet One and Carpet Max, which principally operate as buying groups offering their members economies of scale in the purchasing of floorcovering products.

History of the Flooring Zone

Early Development. Our subsidiary, The Flooring Zone of Georgia, Inc., was founded in June of 2000 with the strategy of developing a full service floorcovering retail operation. Through our subsidiary we initiated our present strategy of providing low-cost product sourcing and advanced specialty retailing capabilities. We have focused on establishing relationships with the leading

carpet suppliers to negotiate favorable purchasing terms. In addition, we seek to hire experienced retailing management personnel and developed product mix, distribution, merchandising, advertising, and promotion, sales training and store operations strategies and resources designed to increase store sales volume and profitability.

Most small independent floorcovering retailers face distinct competitive disadvantages and challenges, including limited purchasing power for products and services, lack of consumer product knowledge, and ineffective asset management, merchandising, selling and store-management techniques. We are significantly smaller than the larger floorcovering retailers who may enjoy better economies of scale. In our experience, however, quality customer service and that personal touch that is often lost when dealing with the larger floorcovering retailers.

Our operating strategies are designed to capitalize on competitive advantages available to the smaller retailer, such as providing excellent customer services and involvement in the local community, while developing and maintaining advantageous buying power and implementing professional retailing operations.

Business Strategy

The principal elements of our business strategy are as follows:

Full-service Retail Formats. A central aspect of our business strategy is the development of a retail format that targets a specific segment of the floorcovering market. Our floorcovering stores offer customers a full range of floorcovering products directly and floorcovering services, including ordering, measuring, delivery and installation through third parties. Our stores typically offer discount floorcovering products held in inventory at the store. We have a small installation staff and can provide installation services. We also maintain strong relationships with several floorcovering installers who can provide installation services to our customers. By primarily outsourcing installation, management believes that we can effectively target both the customer primarily concerned with product selection, quality and customer service, and the customer primarily concerned with price.

Purchasing. We strive to obtain competitive pricing, delivery terms and merchandising programs through good working relationships with floorcovering manufacturers.

4

Professional Retail Management Capabilities. We have invested substantial financial and management resources into the development of information systems, services and infrastructure. We are committed to making shopping for floorcovering products a pleasant experience through the employment of well-trained, knowledgeable and courteous sales associates. As it makes sense, we plan to continue to utilize current technology to improve the operating efficiency of our business.

Centralized Distribution and Limited Inventory Levels. We attempt to minimize our store-level inventories by utilizing our primary distribution center in Brunswick, Georgia. As a result, our retail stores maintain limited amounts of inventory, consisting primarily of product samples and enough inventory to support the cash-and-carry customer.

Multiple Product Categories. We offer a full range of floorcovering products, including broadloom carpets, area rugs, hardwood floorings, ceramic tiles and vinyl floorings, available in both private and branded labels. Multiple product categories allow us to respond to changes in consumer demand.

Our focus on multiple floorcovering products results in decreased carpet sales as a percentage of total retail sales.

Growth Strategy. We have revised our growth strategy to some extent. We still hope to expand to larger markets and to develop a retail floorcovering network in the southeastern United States, we anticipate that this will primarily be accomplished through (i) opening additional company-owned stores and (ii) making selective acquisitions. Because our public offering was significantly less successful than anticipated, rather than fund expansion through with funds raised in our offering, we now intend to expand operations only as cash flow from operations and market conditions so justify. This will result in slower expansion than we originally planned.

Opening of New Stores. If and when we expand, we intend to expand within our existing markets or into contiguous new markets and will attempt to cluster our stores within a market in order to achieve management and operating efficiencies and to enhance our name recognition.

We intend to open new stores in Class A strip shopping retail space and we have developed several standardized store formats ranging from 6,500 to 10,000 square feet to accelerate store openings and minimize store opening costs. The interior store designs include pre-determined product mixes, fixtures and equipment, signage, and point-of-sale advertising and promotional programs. Once a new store site is identified, we will stage the products, merchandising systems and personnel for the new store in our distribution center and headquarters. We believe that we can open a Flooring Zone store within 60 to 90 days of executing a lease, with expected total capital expenditures, initial inventory investments and pre-opening expenses ranging from $75,000 to $150,000 per store. We do not currently intend to offer our stores as franchises.

Broadening of Products and Services. We are developing additional services relating to product installation, maintenance and in-store credit, among others. These additional services, if fully developed, will be utilized by retail operations to increase sales and profitability.

5

Making Selective Acquisitions. As cash flow from operations and market conditions justify, we intend to search for existing floorcovering retail stores that would strengthen our distribution capabilities, that can be reasonably converted into Flooring Zone stores, and that are able to be acquired at or below what we believe our costs would be to open a new store and generate customer traffic.

Company Operations

We provide our retail floorcovering stores with products, services and trained personnel that we believe are top quality. Our resources include merchandising, purchasing and distribution, advertising and promotion, management and sales training and management information systems, as described below.

Purchasing and Distribution. We seek to purchase high-quality products and services at competitive prices. A substantial portion of the floorcovering products purchased by or through our Company are shipped directly by the supplier to our individual retail stores or to our distribution hub. Our stores generally maintain minimal inventory, which predominantly consists of product samples. Our distribution center or hub allows us to make opportunistic purchases from carpet mills at substantially discounted prices. We are also able to offer special purchases to customers, including purchases of mill drops (discontinued lines) and excess mill inventory that are occasionally made available to us at discounted prices. We also make available on an ongoing basis remnant packages and short roll packages which can be as small as 10 and as large as 1,000 remnants at a time. Our ability to purchase and inventory private-label products and specials creates the opportunity for increased revenues and margins and lower pricing to the customer. We have relationships with many vendors within the industry. While we have preferred vendors from whom we purchase a majority of our products, because of our numerous relationships within the industry, we do not believe that we are dependent upon any one vendor for product purchases. Nor do we believe that the loss of any single vendor would have a long-term material adverse effect on our operating results or financial position.

Product Mix and Merchandising. We offer a full range of floorcovering products from key suppliers, including Shaw, Mohawk Industries, Beaulieu of America, DuPont and AlliedSignal for proprietary carpet fiber, Armstrong World Industries and Congoleum for vinyl flooring, Bruce Hardwood Floors (a division of Triangle Pacific) for hardwood flooring and Dal-Tile for ceramic tile. Each of these suppliers is a leader in its respective floorcovering category. Our suppliers also include niche carpet, vinyl, hardwood and ceramic tile producers, as well as leading manufacturers and importers of room-size area rugs.

Our merchandising strategies address effective store layout, fixtures, signage, product mix, and cross-selling techniques designed to increase sales closing performance, average transaction size, sales per square foot of retail space, and gross margins. Store interiors provide easy-to-locate presentation of floorcovering samples, organized by product line, in an attractive and brightly lit interior. In addition, we provide conference rooms where contractors and interior designers can meet with their clients to discuss flooring options.

Advertising and Promotion. We believe advertising and promotion are important to our success. Therefore, we budget a percentage of revenues per market for multimedia advertising campaigns. These campaigns include radio, billboard, print, direct mail and television promotions. To promote our products we also offer our low price guarantee - If you find a local competitor selling your new first quality carpet for less money we will double the difference. We also hold one day "Private Sales" events at each of our retail stores twice a year. Our Private Sales events are conducted by direct mail invitation with coordinated manufacturer's participation.

Management and Sales Training. Our training program focuses on developing professional sales and leadership skills and team building concepts. Our training methodology incorporates a turnkey training and diagnostics system that provides our retail stores with competent and skilled professional personnel.

In addition, our management has ongoing training to keep our employees informed about the latest floorcovering information such as new technology, new products, merchandising, available specials and design trends.

Management Information Systems. Our stores utilize a point-of-sale software system for tracking consumer demographics and purchasing patterns and other data to integrate all store operations into a central information system we spent several years developing in-house.

Credit. Through a national bank we offer consumer credit packages.

Store Operations

Retail Operations. Our stores generate revenues through sales of floorcovering products to consumers and other customers. Each store carries the full product mix available to our Company including several leading brand names. Our stores average 6,500 -10,000 square feet, are typically located in Class A strip shopping retail space in suburban locations, and are staffed with two to six personnel. These stores cater primarily to consumers seeking a variety of high-quality products and customer service. Consumers make purchase selections from floor samples, and the order is usually delivered from our local warehouse or hub, or direct from the manufacturer. We maintain some internal installation staff and have established relationships with several local contractors and usually subcontract installation. Our stores are supported by the full range of services provided by manufacturers, including merchandising and sales promotion programs, high quality advertising, our own integrated information systems, and professionally trained management and sales personnel. Our customers include homeowners, designers, homebuilders and commercial contractors. We are not dependent on one or a few major customers. Our stores compete with other independent retailers, industry franchisees and a small number of national chains, including The Home Depot.

We believe that the Flooring Zone concept utilized in our stores is visually appealing and provides an enjoyable shopping experience for our customers. Our stores standardized layout is professionally designed to include eye-catching signage, bright lighting, a conferencing area and departmentalized product displays. Our stores use floor samples to display the full range of our available products, with separate areas dedicated to carpet, area rugs, hardwood flooring, vinyl flooring and ceramic tiles.

7

Competition

Through our retail stores we compete with other floorcovering retailers in their respective local market areas. According to FLOOR COVERING WEEKLY, the North American market consists of approximately 15,000 individual floorcovering retailers, which represent 25,000 locations. Competition in the retail floorcovering market is intense due to the significant number of retailers in operation. In addition, large retailers have entered the market and provide significant competition, including Home Depot, Inc.

Trademarks, Service Marks, Trade Names and Commercial Symbols

We have registered marks with the U.S. Trademark Office including: "The Flooring Zone" and "Save A Comma." At this time, we know of no infringing uses that could materially affect the use of our service marks, logos or slogans in any state in which stores are or are proposed to be located. We are not the owner or licensee of any patents or copyrights.

Employees

As of the date of this prospectus we employ approximately 9 persons on a full-time basis, including approximately 6 persons at our retail operations and 3 persons at our corporate offices. No employee is a party to any collective bargaining agreement.

ITEM 2. DESCRIPTION OF PROPERTY

Our principal executive offices are located in leased office space located at 3219 Glynn Avenue, Brunswick, Georgia 31520. We also lease warehouse space and space for our two retail stores in Georgia and Florida. We believe these spaces will be adequate for our needs through the terms of their existing leases, the first of which expires in 2007 and the last of which expires in 2014. Based on leases currently have in place, our minimum required annual lease payments for these locations through December 31, 2005, was $238,165 and will be $146,578 for the year ending December 31, 2006.

ITEM 3. LEGAL PROCEEDINGS

Neither us, nor any of our officers or directors is a party to any material legal proceeding or litigation not arising in the ordinary course of business and we know of no material legal proceeding or contemplated or threatened litigation. There are no judgments against us or our officers or directors. None of our officers or directors has been convicted of a felony or misdemeanor relating to securities or performance in corporate office.

8

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

No matters were submitted to a vote of our shareholders during the fiscal year ended December 31, 2005.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

At present, our securities are not traded publicly. There is no assurance that a trading market will develop, or, if developed, that it will be sustained. Our shareholders may, therefore, find it difficult to resell their securities. Furthermore, our shares are not marginable and it is unlikely that a lending institution would accept our common stock as collateral for a loan.

During the quarter ended December 31, 2005 we sold no shares that were not registered under the Securities Act of 1933.

During the quarter ended December 31, 2005 we completed a public offering of a maximum of 10,000,000 shares of our common stock at a price of $2.00 per share, for an aggregate offering of up to $20,000,000. This public offering was registered with the Securities and Exchange Commission pursuant to an SB-2 registration statement. Our SB-2 registration statement was declared effective by the Securities and Exchange Commission on January 31, 2005 and we commenced our public offering at that time. The Commission file number assigned to this registration statement is 333-119234.

We sold 141,050 common shares in the offering raising $282,100. Under the terms of the offering, the offering terminated on October 28, 2005.

The offering was completely self-underwritten and was conducted by our officers and directors. No underwriting discounts and commissions, finders' fees or expenses were paid.

In accordance with the use of proceeds set forth in the registration statement, as of December 1, 2005, all of the funds raised in the offering have been used to reduce outstanding debt obligations of the Company. Of the

$282,100, approximately $29,000 was paid to reduce amounts owed on a line of credit extended to us by Michael Carroll and a note payable to Michael Carroll. Mr. Carroll is an officer and director of the Company.

Of our 19,569,250 common shares currently outstanding, 140,550 are free-trading and 19,428,700 shares have been held for more than one year and would be eligible for resale in compliance with the provisions of Rule 144.

As of April 14, 2006, we had 107 shareholders of record.

Cash Dividends

We have not declared a cash dividend on any class of common equity in the last two fiscal years. There are no restrictions on our ability to pay cash dividends, other than state law that may be applicable; those limit the ability to pay out all earnings as dividends. The Board of Directors does not, however, anticipate paying any dividends in the foreseeable future; it intends to retain the earnings that could be distributed, if any, for the operations, expansion and development of our business.

Repurchases of Equity Securities

During the quarter ended December 31, 2005, we did not repurchase any of our equity securities.

At the time of his resignation as an officer and director of the Company, Mr. Jimmy Lee agreed to the cancellation of his 19,000,000 common shares in exchange for his release as a personal guarantor on all obligations of the Company. The cancellation of Mr. Lee's shares occurred during the second quarter 2006.

Securities for Issuance Under Equity Compensation Plans

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of secur remaining avail issuance under compensation pl (excluding secu columns (a)) (
Equity compensation plans approved by security holders	-0-	$0.00	450
Equity compensation plans not approved by security holders	-0-	$0.00	
Total	-0-	$0.00	45

On May 13, 2003 we adopted The Flooring Zone, Inc., 2003 Stock Incentive Plan (the "Plan"). The Plan allow us to grant options to our key employees, officers, directors, consultants, advisors and sales representatives to purchase up to 500,000 shares of its $.001 par value restricted common stock at an exercise price to be determined by the Stock Option Committee of the board at the time of grant.

On June 18, 2003 we granted options under the Plan to 26 employees to purchase an aggregate of 45,000 shares of our common stock at an exercise price of $1.25. The options vested immediately and expired on June 18, 2005. Between June 20, 2003 and September 30, 2003 all of the options were exercised.

There are currently no options, warrants or rights outstanding under the Plan.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

This discussion summarizes the significant factors affecting our consolidated operating results, financial condition, liquidity and capital resources during our fiscal years ended December 31, 2005 and 2004. This discussion should be read in conjunction with the financial statements and financial statement footnotes included in this registration statement.

Forward-Looking Statements

Certain statements of our expectations contained herein, including, but not limited to statements regarding sales growth, new stores, increases in comparable store sales, commodity price inflation and deflation, and capital expenditures constitute "forward-looking statements." Such statements are based on currently available operating, financial and competitive information and are subject to various risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations. These risks and uncertainties include but are not limited to, fluctuations in and the overall condition of the U.S. economy, stability of costs and availability of sourcing channels, conditions affecting new store development, our ability to implement new technologies and processes, our ability to attract, train, and retain highly-qualified associates, unanticipated weather conditions and the impact of competition and regulatory and litigation matters. Undue reliance should not be placed on such forward-looking statements, as such statements speak only as of the date on which they are made.

Going Concern

The Report of Independent Registered Public Accounting Firm contains an opinion that we will need additional working capital to service our debt and fund our planned activities, which raises substantial doubt about our ability to continue as a going concern. We have not generated sufficient revenue from operations to meet our operating expenses, have accumulated a deficit of $2,171,287 since inception and have a negative working capital of $1,266,812. This raises substantial doubt about our ability to continue as a going concern. To continue operations, we will need to obtain funding from third parties. This funding may be sought by means of private equity or debt financing. We currently have no commitments from any party to provide funding and there is no way to predict when, or if, any such funding could materialize. There is no assurance that we will be successful in obtaining additional funding on attractive terms or at all. If we are unsuccessful in obtaining additional funding, we may be unable to continue operations as we have insufficient working capital necessary to meet its expenses and service our debt.

Results of Operations

In fiscal 2005, we realized lower revenues as sales decreased while costs of sales increased as compared to fiscal 2004. During fiscal 2004 we enjoyed record high revenues. As a result of lower revenues and increased costs, our net loss and net loss per shares in fiscal 2005 increased as compared to fiscal 2004.

Revenues

We generate revenue primarily from the sale of flooring products. We sell flooring products to two groups - retail customers and contractors. Retail customers generally pay higher prices for products than contractors. Typically, about 70% of our product sales are to retail customers and 30% of our product sales are to contractors.

During the twelve months ended December 31, 2005, we realized net revenue of $3,043,852, a 19% decrease compared to the twelve months ended December 31, 2004. The decrease in net revenue during the year ended December 31, 2005 is the result of several factors. During fiscal 2004 we provided flooring products for a large condominium project and a local hospital. These contracts are non-typical for our business. In fiscal 2005 the volume of sales we typically engage in was also lower than in fiscal 2004. This was partly the result of the closing of our St. Mary's store and a reduction in our sales force in the fourth quarter 2005. Additionally, in 2005 we began offering a wider range of financing plans to our customer, including offering the option of zero percent financing. As a result of certain financing options, we realized lower revenues on financed sales.

With the closing of our St. Mary's store during the fourth quarter 2005, we anticipate sales volume in 2006 could be slightly lower than sales volume experienced in 2005. We plan to engage in more aggressive marketing and advertising to offset this reduction in sales volume. While sales volume may be somewhat lower in 2006, we expect revenue to remain fairly consistent with revenue earned in 2005. We believe we can improve revenue in 2006 even if sales

volume is somewhat lower because we now have a better understanding of how certain financing plans affect our revenues. With this knowledge, we have changed our pricing structures to insure that we maintain appropriate sales margins.

Gross Profits

Our gross profits are directly affected by our costs of sales. Cost of sales includes all direct costs of floor coverings, materials used in installation and installation labor. As with revenues, our cost of sales and gross profits are directly affected by changes in the percentage of products sold to retail customers versus contractors. As discussed above, the prices we can charge contractors are lower than the prices we can charge retail customers, therefore, our profit margin on product sales to retail customers is greater. Moreover, we typically also realize profit from the sale of materials used in installation and from the costs charged for installation labor to retail customers. Conversely, contractors typically use their own subcontractors to install the floor covering products they purchase. These subcontractors provide the materials used in installation and the installation labor.

Gross profit during the year ended December 31, 2005, was $284,336, 75% lower than the $1,147,069 gross profit realized during the year ended December

31, 2004. Cost of sales as a percentage of net revenues in 2005 was nearly 91% in 2005, compared to 70% in 2004. We believe this significant increase in cost of sales as a percentage of net revenues was the result of several factors. First, during the 2005 fiscal year we realized lower margins on products sold as overall the cost of products increased at a greater rate than the cost we charged our customers. Second, on a number of occasions we experienced swift cost increases in products, which we had already sold to customers, but had not yet ordered or installed. Our sales policies in 2005 contracts did not provide any way for us to pass these increased costs to our customers. We are currently developing an implementing a new sales policy that allows us to pass increased product prices to our customers. Third, as a result of decreased revenues, our accounts payable to certain vendors increased to levels where we were no longer offer us advantageous price breaks. During the first quarter 2006, we have reduced our accounts payable with these vendors to level that once again allow us to enjoy competitive pricing advantages.

As discussed above, we are currently implementing new policies and resolving outstanding accounts with vendors. We believe this will help us to reduce cost of sales as a percentage of net revenues and will bring our sales margins more in line with the percentages experienced in the years prior to 2005. We also believe that certain events, such as Hurricane Katrina, which resulted in rapid and significant increases in products prices are unlikely to repeat in the upcoming fiscal year.

General and Administrative Expenses

General and administrative expenses for the year ended December 31, 2005, increased $95,088, or 7% to $1,369,497 compared to the year ended December 31, 2004, and as a percentage of sales revenue increased from 34% during the year ended December 31, 2004, to 45% during the year ended December 31, 2005. During the twelve months ended December 31, 2005 and 2004, general and administrative costs consisted of:

	Year ended December 31, 2005	Year ended December 31, 2004
Salaries & benefits costs	$ 576,802	$ 584,700
Advertising & display costs	86,807	64,348
Occupancy costs & utilities	356,053	305,628
Legal & accounting costs	79,385	37,979
Other	270,450	281,754
	$ 1,369,497	$ 1,274,409

The reduction in salaries and benefits costs in the year ended December 31, 2005 compared to 2004, is largely the result of a reduction in our sales force with the closing of our St. Mary's store and a reduction in the number of in-house installers we employed. The overall reduction in salaries was partially offset by an increase in worker's compensation expenses of approximately $25,000. We do not anticipate additional reductions to our workforce at this time. Nor do we anticipate an increase in our workforce until such time as revenue from operations, need and market conditions justifies expansion of our operations.

During the year ended December 31, 2005, we increased our advertising and display costs by 35% compared to the same period of 2004, in an effort to increase slumping sales volume. In 2006, we anticipate advertising costs will continue to be consistent or somewhat higher than advertising costs in 2005 as we continue to attempt to improve sales volume and revenues.

Occupancy costs and utilities during the year ended December 31, 2005, compared to the same period of 2004, increased 16%. When we closed the St. Mary's store we were required to buy out the remaining term of the lease. The 26% increase in occupancy costs and utilities is directly attributable to this event. We anticipate occupancy costs and utilities in 2006 will be lower than 2005 as a result of the closing of the St. Mary's store.

Legal and accounting costs increased 109% during the year ended December 31, 2005 compared to the year ended December 31, 2004. This increase is the result of increased reporting obligations associated with being a public reporting company. We expect legal and accounting expenses will likely continue to increase in the 2006 fiscal year.

Other costs remained fairly constant in 2005 decreasing approximately 4% compared to 2004. We anticipate other expenses to remain relatively constant in 2006.

Net Loss

Our net loss in fiscal 2005 was $1,197,754 compared to $195,124 in fiscal 2004. As discussed above, this increase in net loss is primarily the result of decreased product sales and increased cost of goods sold in 2005 compared to 2004.

Liquidity and Capital Resources

Our capital resources have consisted of revenues from operations, funds raised through the sale of our common stock and debt. On January 31, 2005, our SB-2 registration statement was declared effective by the Securities and Exchange Commission and we commenced selling shares of our common stock at $2.00 per share. On October 28, 2005, we closed the public offering, as per its terms. We raised a total of $282,100 in the offering. We anticipate our capital resources in the upcoming twelve months will consist primarily of revenues from operations and borrowing funds.

During fiscal 2005 and 2004 cash was primarily used to fund operations. See below for additional discussion and analysis of cash flow.

	Fiscal 2005	Fiscal 2004
Net cash used in operating activities	$(1,227,371)	$ (314,976)
Net cash used in investing activities	$ (7,748)	$ (40,100)
Net cash provided by financing activities	$ 1,209,309	$ 390,154
NET INCREASE/(DECREASE) IN CASH	$ (25,810)	$ 35,078

As discussed herein, during fiscal 2005 compared to fiscal 2004, product sales decreased while costs of goods and general and administrative expenses increased leading to an increase in net loss of $1,002,630 to $1,197,754. During year ended December 31, 2005, as product sales have slumped, we have had less revenue to purchase inventory and inventory has decreased by $72,567. For the same reason, accounts receivable have decrease $19,453. Customer deposits for the twelve months ended December 31, 2005, increased $38,248. This increase in customer deposits is attributable to a delay in completing jobs because of inventory shipping delays. Accounts payable decreased by $220,085 as we made a conscious effort to reduce amounts owed to vendors in an effort to improve our relations and hopefully the pricing we receive from the vendors we work with. Net cash used in operating activities during fiscal 2005 was 290% higher than net cash used in operating activities in fiscal 2004. This increase in cash used in operating activities during fiscal 2005 was largely the result of the circumstances explained above.

We used $7,748 cash in investing activities in 2005 to acquire equipment. By comparison, we used $40,100 in cash in investing activities in 2004.

Net cash provided from financing activities increased $819,155, or 210% in fiscal 2005, compared to fiscal 2004. During the twelve months ended December 31, 2005, proceeds from borrowing on a related party line of credit totaled $1,178,725 and we realized proceeds from the issuance of common stock in our public offering of $282,100. These amounts were only partially offset by payments on long term debt of $251,516.

At December 31, 2005 and 2004, we had cash on hand of $64,282 and $90,092, respectively.

Summary of Material Contractual Commitments

The following table lists our significant commitments as of December 31, 2005.

			Payments Due by Fiscal Year		
Contractual Commitments	Total	2006	2007	2008	2
Lines of Credit-Related Party	$1,205,725	$1,205,725	$ --	$ --	$
Note Payable-Related Party	98,786	47,413	51,373	--	
Note Payable	495,853	44,373	47,344	50,515	3
Capital Leases	19,292	10,473	8,819	--	
Operating Leases	761,294	146,578	149,338	152,170	1
TOTAL	$2,580,950	$1,454,562	$ 256,874	$ 202,685	$ 5

Off-Balance Sheet Financing Arrangements

As of December 31, 2005 and 2004, we had no off-balance sheet financing arrangements.

Critical Accounting Policies

Revenue Recognition

We recognize revenues in accordance with the Securities and Exchange Commission, Staff Accounting Bulletin (SAB) number 104, "Revenue Recognition in Financial Statements." SAB 104 clarifies application of U. S. generally accepted accounting principles to revenue transactions. Accordingly, revenue is recognized when an order has been received, the price is fixed and determinable, the order is shipped and installed, collection is reasonably assured and we have no significant obligations remaining. Licensing fees are royalties paid to us for licensing the use of the name The Flooring Zone. The royalties range from

1-2% of the licensee's commercial sales volume.

We record accounts receivable for sales which have been delivered but for which money has not been collected. An allowance for doubtful accounts is provided for accounts deemed potentially uncollectible based on analysis and aging of accounts. For customer purchases or deposits paid in advance, we record a liability until products are shipped or installed.

Merchandise Inventory

We record inventory at the lower of cost or market, cost being determined on a first-in, first-out method. We do not believe our merchandise inventories are subject to significant risk of obsolescence in the near-term, and we have the ability to adjust purchasing practices based on anticipated sales trends and general economic conditions.

16

Vendor Funds

We receive funds from vendors in the normal course of business for purchase-volume-related rebates. Our accounting treatment for these vendor-provided funds is consistent with Emerging Issues Task Force (EITF) 02-16 "Accounting by a Customer (Including a Reseller) for Certain Consideration Received From a Vendor." Under EITF 02-16, purchase volume rebates should be treated as a reduction of inventory cost, unless they represent a reimbursement of specific, incremental and identifiable costs incurred by the customer to sell the vendor's product. The purchase volume rebates that we receive do not meet the specific, incremental and identifiable criteria in EITF 02-16. Therefore, they are treated as a reduction in the cost of inventory and we recognize these funds as a reduction of cost of sales when the inventory is sold.

Recently Issued Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123R, Share-based Payment. This standard is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123R requires the measurement of the cost of employees services received in exchange for an award of the entity's equity instruments based on the grant-date fair value of the award. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render service. The Company will adopt SFAS No. 123R on January 1, 2006, which will require stock-based compensation expense to be recognized against earnings for the portion of outstanding unvested awards, based on the grant date fair value of those awards calculated using a Black-Scholes pricing model under SFAS 123 for pro forma disclosure. The Company is currently evaluating to what extent the entity's equity instruments will be used in the future for employees services and the transition provisions of this standard; therefore, the impact to the Company's financial statements of the adoption of SFAS No. 123R cannot be predicted with certainty.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, Inventory Pricing, to clarify that for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage), should be expensed as incurred and not included in overhead. In addition, this Statement requires the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions in SFAS No. 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The

Company is currently assessing the impact of SFAS no. 151 on its consolidated financial statements.

In December 2004, the FASB issued Staff Position No. FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004 (the "Act") that provides a tax deduction on qualified production activities. Accordingly FASB indicated that this deduction should be accounted for as a special deduction in accordance with FASB Statement No. 109. The Company will comply with the provisions of FSP 109-1 effective January 1, 2005, and does not believe that the adoption of this FASB Staff Position will have a material impact on the Company's financial statements.

17

ITEM 7. FINANCIAL STATEMENTS

The Flooring Zone, Inc.

Report of Independent Registered Public Accounting Firm
And
Consolidated Financial Statements

December 31, 2005

18

The Flooring Zone, Inc.

TABLE OF CONTENTS

	Page
Report of Independent Registered Public Accounting Firm................	20
Consolidated Balance Sheet-December 31, 2005...........................	21-22
Consolidated Statements of Operations for the Years Ended December 31, 2005 and 2004..	23
Consolidated Statements of Stockholders' Deficit for the Years Ended December 31, 2005 and 2004....................................	24
Consolidated Statements of Cash Flows for the Years Ended December 31, 2005 and 2004..	25
Notes to Consolidated Financial Statements.............................	26

19

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
The Flooring Zone, Inc.

We have audited the accompanying consolidated balance sheet of The Flooring Zone, Inc. as of December 31, 2005 and the related consolidated statements of operations, stockholders' deficit, and cash flows for the years ended December 31, 2005 and 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Flooring Zone, Inc. and subsidiaries as of December 31, 2005 and the results of operations and cash flows for the years ended December 31, 2005 and 2004, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming the Flooring Zone, Inc. will continue as a going concern. As discussed in Note 12 to the financial statements, the Company has accumulated losses from operations and a deficit in working capital. These issues raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 12. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Mantyla McReynolds

Mantyla McReynolds
Salt Lake City, Utah
February 23, 2006

20

The Flooring Zone, Inc.
Consolidated Balance Sheet
December 31, 2005

ASSETS

Current assets:	
Cash	$
Accounts receivable, net of allowance of $20,426	
Inventory-Notes 1 & 3	
Prepaid expenses	
Total current assets	
Property & equipment, net - Notes 1 & 2	
Other assets:	
Intangible assets, net of accumulated amortization of $2,380	
Deposits	
Total other assets	
TOTAL ASSETS	$

See accompanying notes to financial statements

21

The Flooring Zone, Inc.
Consolidated Balance Sheet [continued]
December 31, 2005

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current liabilities:	
Accounts payable	$
Line of credit-related party-Note 7	1,
Customer deposits	
Accrued liabilities	
Current portion long-term debt - Note 8	
Total current liabilities	1,

Long-term liabilities:-Note 8	
Notes payable-related party	
Long-term debt	
Current portion long-term debt	(
Total long-term liabilities	
Total liabilities	2,
Stockholders' deficit:-Note 5	
Preferred Stock, 10,000,000 shares authorized $.001 par value: No shares issued and outstanding	
Common stock, 100,000,000 shares authorized $.001 par value; 38,569,750 shares issued and outstanding	
Additional paid in capital	
Accumulated deficit	(2,
Total stockholders' deficit	(1,
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$

See accompanying notes to financial statements

22

The Flooring Zone, Inc.
Consolidated Statements of Operations
For the years ended December 31, 2005 and 2004

Revenues:	2005	2004
Sales	$ 3,041,352	$ 3,769,343
Licensing Fees	2,500	5,219
Net revenues	3,043,852	3,774,562
Less cost of sales	2,759,516	2,627,493

Gross profit	284,336	1,147,069
General and administrative expenses	1,369,497	1,274,409
Loss on disposal of assets	18,667	-
Net income (loss) from operations	(1,103,828)	(127,340)
Other income/expense:		
Interest expense	(93,926)	(67,784)
Total other income/(expense)	(93,926)	(67,784)
Net income (loss) before taxes	(1,197,754)	(195,124)
Provision for income taxes	-	-
Net income (loss)	$ (1,197,754)	$ (195,124)
Net Loss per share-basic and diluted	$ (0.03)	$ (0.01)
Weighted average shares outstanding-basic and diluted	38,499,110	38,406,689

See accompanying notes to financial statements

23

The Flooring Zone, Inc.
Consolidated Statements of Stockholders' Deficit
For the Years Ended December 31, 2005 and 2004

	Shares Issued	Common Stock	Additional Paid in Capital	Accounts Receivable, Shareholder	A
Balance, January 1, 2004	38,352,700	$ 38,353	$ 308,881	$ (12,500)	$
Shares issued for cash at $1.25/share in 2004	76,000	76	94,924		
Payments received on shares issued in 2003				12,500	
Net loss for year ended December 31, 2004					

Balance, December 31, 2004	38,428,700	38,429	403,805	-	
Stock issuance costs			(77,507)		
Shares issued for cash at $2.00/share	141,050	141	281,959		
Net loss for year ended December 31, 2005					
Balance, December 31, 2005	38,569,750	$ 38,570	$ 608,257	$ -	$

See accompanying notes to financial statements

24

The Flooring Zone, Inc.
Consolidated Statements of Cash Flows
For the years ended December 31, 2005 and 2004

	2005	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (1,197,754)	$
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	42,706	
Loss on disposal of assets	18,667	
Decrease (increase) in accounts receivable	19,453	
Decrease (increase) in inventories	72,567	
Decrease (increase) in employee loans and advances	-	
Decrease (increase) in prepaid expenses	(2,230)	
Decrease (increase) in deposits	-	
Increase (decrease) in accounts payable	(220,085)	
Increase (decrease) in accrued liabilities	1,057	
Increase (decrease) in customer deposits	38,248	
Net cash used in operating activities	(1,227,371)	
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(7,748)	
Purchase of intangible assets	-	
Net cash used in investing activities	(7,748)	
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowing (payments) on line of credit-related party	1,178,725	

Proceeds from borrowing on long term debt	-	
Payments on long term debt	(251,516)	
Proceeds from the issuance of common stock	282,100	
Net cash provided by financing activities	1,209,309	
NET INCREASE (DECREASE) IN CASH	(25,810)	
CASH AT BEGINNING OF YEAR	90,092	
CASH AT END OF YEAR	$ 64,282	$
SUPPLEMENTAL DISCLOSURES		
Cash paid for interest	$ 83,760	$
Cash paid for income taxes	-	
Issued stock to relinquish debt	-	

See accompanying notes to financial statements

25

The Flooring Zone, Inc.
Notes to Consolidated Financial Statements
December 31, 2005

Note 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - The Flooring Zone, Inc. (the Company) is a corporation organized under the laws of the State of Nevada on May 5, 2003. On May 13, 2003 pursuant to a Share Exchange Agreement, the Company acquired all of the outstanding common stock of The Flooring Zone of Georgia, Inc (the Georgia Company), a Georgia Corporation, in exchange for 38,125,000 shares of common stock of the Company. The company's business operations provide for full-service retail floor covering products and services.

The financial statements of the Company have been prepared in accordance with generally accepted accounting principles. The following summarizes the more significant of such policies:

Principles of Consolidation - The accompanying consolidated financial statements include the accounts of The Flooring Zone, Inc. and its wholly owned subsidiary, The Flooring Zone of Georgia, Inc. All significant intercompany balances and transactions are eliminated.

Revenue Recognition - The Company recognizes revenue according to Staff Accounting Bulletin 104, Revenue Recognition which clarifies U.S. generally accepted accounting principles for revenue transactions. Accordingly, revenue is recognized when an order has been received, the price is fixed and determinable, the order is shipped and installed, collection is reasonably assured and the Company has no significant obligations remaining. Licensing fees are royalties paid to the Company for licensing the use of the name The Flooring Zone. The royalties range from 1-2% of the licensee's commercial sales volume.

Use of Estimates in Preparation of Financial Statements - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents - The Company considers all highly liquid investments with original maturities at the date of purchase of three months or less to be cash equivalents.

Bad debt and allowance for doubtful accounts - The allowance for doubtful accounts is maintained at a level sufficient to provide for estimated credit losses based on evaluating known and inherent risks in the receivables portfolio. The Company provides an allowance for doubtful accounts which, based upon management's evaluation of numerous factors, including economic conditions, a predictive analysis of the outcome of the current portfolio and prior credit loss experience, is deemed adequate to cover reasonably expected losses inherent in outstanding receivables.

Concentrations of credit risk - Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of trade receivables. The Company provides credit to its customers in the normal course of business, and accordingly performs ongoing credit evaluations and maintains allowances for potential credit losses. Concentrations of credit with respect to trade receivables are limited due to the Company requiring a deposit from customers.

Inventory - Inventories are stated at the lower of cost or market, cost being determined on a first-in, first-out method.

Note 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - [continued]

Vendor Funds - We receive funds from vendors in the normal course of business for purchase - volume-related rebates. Our accounting treatment for these vendor-provided funds is consistent with Emerging Issues Task Force (EITF) 02-16 "Accounting by a Customer (Including a Reseller) for Certain Consideration Received From a Vendor." Under EITF 02-16, purchase volume rebates should be treated as a reduction of inventory cost, unless they represent a reimbursement of specific, incremental and identifiable costs incurred by the customer to sell the vendor's product. The purchase volume rebates that we receive do not meet the specific, incremental and identifiable criteria in EITF 02-16. Therefore, they are treated as a reduction in the cost of inventory and we recognize these funds as a reduction of cost of sales when the inventory is sold.

Property and Equipment - Property and equipment are stated at cost. Expenditures for maintenance and repairs are charged to expense as incurred. The following is a summary of the estimated useful lives and depreciation methods used in computing depreciation expense:

Asset	Depreciation Method	Estimated useful life
Equipment	Straight-line	5-10 years
Furniture and fixtures	Straight-line	10-15 years
Vehicles	Straight-line	10 years
Leasehold improvements	Straight-line	10 years
Displays	Replacement	N/A

Intangible Assets - Intangible assets include trademarks that have been registered with the United States Patent and Trademarks office. Intangible assets also include the closing costs for refinancing a portion of the Company's debt with a bank. The costs of obtaining trademarks and closing costs are capitalized as incurred and are amortized over their estimated useful lives of fifteen years and five years, respectively, using the straight-line method. Amortization expense for the years ended December 31, 2005 and 2004 were $1,014 and $611, respectively.

Income Taxes - In July 2000 the Company elected to be taxed as an S Corporation under the Internal Revenue Service Code. Accordingly, under such an election, the Company's taxable income was reported by the individual shareholders. In 2003 the Company cancelled its election to be taxed as an S Corporation and therefore applies the provisions of Statement of Financial Accounting Standards(SFAS) No. 109, Accounting for Income Taxes which requires an asset and liability approach for financial accounting and reporting for income taxes, and the recognition of deferred tax assets and liabilities for the temporary differences between the financial reporting basis and tax basis of the Company's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled.

Net Loss Per Common share - In accordance with SFAS No. 128, Earnings Per Share, basic loss per common share is computed using the weighted average number of common shares outstanding. Diluted earnings per share is computed using weighted average number of common shares plus dilutive common share equivalents outstanding during the period using the treasury stock method. At December 31, 2005 there are no common stock equivalents outstanding, thus, basic and diluted loss per share calculations are the same.

27

The Flooring Zone, Inc.
Notes to Consolidated Financial Statements
December 31, 2005

Note 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - [continued]

Stock based compensation - SFAS No. 123, Accounting for Stock-Based Compensation allows companies to choose whether to account for employee stock-based compensation on a fair-value method, or to account for such compensation under the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to

Employees (APB 25). The Company has chosen to account for stock-based compensation using APB 25. If the compensation cost for the Company's compensation plan had been determined consistent with SFAS No. 123 the Company's net income and net income per common share would have changed to the pro forma amounts indicated below:

	2005	2004
Net loss, as reported	$ (1,197,754)	$ (195,124)
Compensation cost under fair value-based accounting method, net of tax	-	-
Net loss, pro forma	(1,197,754)	(195,124)
Net loss per share-basic and diluted:		
As reported	$ (0.03)	$ (0.01)
Pro forma	$ (0.03)	$ (0.01)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0%; expected volatility of 0%; risk-free interest rate of 3% and expected lives of 3,650 days(See note 6).

Advertising Costs - Advertising costs of the Company are charged to expense as incurred. Advertising expense amounted to $79,790 and $53,102 in 2005 and 2004, respectively.

Recently Issued Financial Accounting Standards--In December 2004, the FASB issued SFAS No. 123R, Share-based Payment. This standard is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123R requires the measurement of the cost of employees services received in exchange for an award of the entity's equity instruments based on the grant-date fair value of the award. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render service. The Company will adopt SFAS No. 123R on January 1, 2006, which will require stock-based compensation expense to be recognized against earnings for the portion of outstanding unvested awards, based on the grant date fair value of those awards calculated using a Black-Scholes pricing model under SFAS 123 for pro forma disclosure. The Company is currently evaluating to what extent the entity's equity instruments will be used in the future for employees services and the transition provisions of this standard; therefore, the impact to the Company's financial statements of the adoption of SFAS No. 123R cannot be predicted with certainty.

Note 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - [continued]

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, Inventory Pricing, to clarify that for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage), should be expensed as incurred and not included in overhead. In addition, this Statement requires the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions in SFAS No. 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not feel the adoption of SFAS No. 151 will have a material affect on their financial statements.

Note 2 PROPERTY AND EQUIPMENT

The major categories of property and equipment are as follows:

	12/31/2005
Equipment	$ 134,146
Furniture and fixtures	21,331
Vehicles	20,127
Leasehold improvements	131,721
Displays	85,522
Accumulated depreciation	(150,772)
Net property and equipment	$ 242,075

Included in equipment are assets totaling $29,978 which are financed by capital lease. Related amortization is included in accumulated depreciation. Depreciation expense was $41,692 in 2005 and $38,773 in 2004.

Note 3 INVENTORY

Inventories are stated at lower of cost or market and consist of the following:

	12/31/05
Flooring material	230,607
Total	$ 230,607

Note 4 INCOME TAXES

Below is a summary of deferred tax asset calculations on net operating loss carry forward amounts. Loss carry forward amounts expire through 2025. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized.

The Flooring Zone, Inc.
Notes to Consolidated Financial Statements

December 31, 2005

Note 4 INCOME TAXES - [continued]

Description	NOL Balance	Tax	Rate
Federal Income Tax	$1,657,403	$563,517	34%
Georgia State Income Tax	1,657,403	99,444	6%
Valuation allowance		(662,961)	
Deferred tax asset 12/31/2005		$ 0	

The allowance has increased $395,327 from $267,634 as of December 31, 2004.

Note 5 COMMON STOCK/PREFERRED STOCK

In February 2004 the Company received proceeds of $12,500 for 10,000 shares of its common stock that were issued in September 2003.

In May 2004 pursuant to Rule 506 of Regulation D of the Securities Act of 1933 the Company accepted the Subscriptions and Investment Representation Letters from 3 investors and issued 76,000 shares of its restricted common stock at a price of $1.25 per share for a total of $95,000.

The Company's preferred stock may be issued from time to time in one or more series. The Board of Directors are to establish by resolution(s) the number of shares to be included in each series, and to fix the designation, powers, preferences and rights of the shares of each such series and the qualifications, limitations or restrictions thereof. As of December 31, 2005 no shares of preferred stock have been issued by the Company.

The Company's SB-2 Registration statement filed with the Securities and Exchange Commission became effective in January 2005. In 2005, the Company had raised $282,100 and issued 141,050 shares of its common stock. Costs associated with issuing this stock totaled $77,507.

In November 2005, Jimmy Lee resigned as the Company's President, CEO and director. Mr. Lee returned his 19,000,000 shares of the Company's common stock. In return the Company agreed to remove his name from all debt and personal guarantees. As of December 31, 2005 the Company had received the stock certificate but had not yet canceled it because Mr. Lee's name has not been completely removed from all debt. The 19,000,000 shares are showing as issued and outstanding in these financial statements.

Note 6 STOCK OPTION PLAN

On May 13, 2003 the Company's Board of Directors adopted the Company's 2003 Stock Incentive Plan (The Plan). The Plan grants options to its key employees, officers, directors, consultants, advisors and sales representatives to purchase up to 500,000 shares of its $.001 par value restricted common stock at an exercise price determined by the Stock Option Committee of the board at the time of grant. The options fully vest upon the date of grant. No stock options were granted, exercised or outstanding during the years ended December 31, 2005 and 2004.

Note 7 LINE OF CREDIT-RELATED PARTY

During the year ended December 31, 2003 the Company obtained a line of credit with a shareholder of the Company for the purpose of meeting cash flow needs. The interest rate on the line of credit is prime plus 1%. As of December 31, 2005 and 2004, the outstanding balances on this line were $115,000 and $27,000, respectively. In October 2005, the Company obtained a line of credit from a related company, whose owner is a shareholder and director of the Company, for $200,000 which was outstanding at December 31, 2005 with an interest rate of prime plus 1% maturing within twelve (12) months. In December 2005, the Company obtained lines of credit with a shareholder and related company, whose owner is a shareholder and director of the Company, totaling $950,000 of which $890,725 was outstanding at December 31, 2005 with an interest rate of prime plus 1% all maturing within twelve (12) months. The interest rate on the lines of credit at December 31, 2005 was 8.00%.

Note 8 LONG-TERM DEBT

The following is a summary of the Company's indebtedness as of December 31, 2005:

Note payable to a bank with interest at 6.50% due in monthly installments of $6,270.32 through August 2009, secured by Company equipment and property owned by the Company's president.	$ 495,853
Note payable to a shareholder with interest at 10.00% due in monthly installments of $4,565.33 through October 2007, unsecured.	98,786
Lease payable to Dell Financial with interest at 17.06% due in monthly installments of $1069.63 through August 2007, secured by equipment.	19,292
Total	$ 613,931

Maturities of debt are as follows:

Year Ending December 31:	Amount
2006	$ 102,259
2007	107,536
2008	50,515
2009	353,621

Thereafter		-
	$	613,931

The Flooring Zone, Inc.
Notes to Consolidated Financial Statements
December 31, 2005

Note 9 LEASES

The Company has entered into three operating leases with unrelated parties for its retail stores, warehouse and office facilities. The leases expire between 2007 and 2014. During the year ended December 31, 2005, and 2004 the Company paid lease payments in the amount of $238,165 and $226,690, respectively. In 2005 and 2004 the Company also leased on a month to month basis additional office space totaling $14,400 each year. In November 2005, the Company terminated the lease on the St. Marys Store (See note 11).

The following is a schedule by years of future minimum lease payments required under operating leases that have initial or remaining noncancellable lease terms in excess of one year as of December 31, 2005:

Year ended		Total
December 31, 2006	$	146,578
December 31, 2007		149,338
December 31, 2008		152,170
December 31, 2009		155,098
December 31, 2010		158,110
Totals	$	761,294

Note 10 CONTINGENCIES

The Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position. However, an unfavorable outcome in these claims could result in a possible judgment against the company of as much as $6,500.

The Company records contingent losses when they are probable and reasonably estimable. The Company and their legal council have determined that these liabilities are possible but not probable.

Note 11 CLOSED OPERATIONS

The Company closed the St. Marys, Georgia store in November 2005, due to poor performance. All inventory was transferred to the Yulee or Brunswick Stores. The Company paid $18,000 to terminate its lease. The leasehold improvements totaling $18,667 were written off in 2005.

32

The Flooring Zone, Inc.
Notes to Consolidated Financial Statements
December 31, 2005

Note 12 GOING CONCERN

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the financial statements, the Company has an accumulated deficit of $2,171,287, and a negative working capital of $1,266,812. These factors raise substantial doubt about the Company's ability to continue as a going concern.

Management plans include obtaining additional debt financing to cover the shortfalls in revenue and allowing the Company to begin purchasing inventory at a discount, and making changes in operations to reduce expenses and improve margins. The Company may also seek additional equity financing through the sale of its shares, although the Company currently has no commitments for additional equity financing and there is no guarantee that the Company can obtain equity financing on acceptable terms or at all. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

33

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 8A. CONTROLS AND PROCEDURES

Our principal executive officers and our principal financial officer (the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Such officers have concluded (based upon their evaluations of these controls and procedures as of the end of the period covered by this report) that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in this report is accumulated and communicated to management, including the Certifying Officers as appropriate, to allow timely decisions regarding required disclosure.

The Certifying Officers have also indicated that there were no significant changes in our internal controls over financial reporting or other factors that could significantly affect such controls subsequent to the date of their evaluation, and there were no significant deficiencies and material weaknesses.

Our management, including the Certifying Officers, does not expect that our disclosure controls or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. The design of any systems of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of these inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

34

ITEM 8B. OTHER INFORMATION

On April 21, 2006, Mr. Steven Nichols resigned as the Company's Chief Financial Officer. Mr. Nichols' resignation was not the result of any disagreement with the Company on any matter relating to the Company's operations, policies or practices.

The Company's board of directors has not yet determined who it will appoint to replace Mr. Nichols as the Company's Chief Financial Officer. Until such time as the board appoints a new Chief Financial Officer, Michael Carroll will assume that responsibility on an interim basis.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLAINCE WTH SECTION 16(a) OF THE EXCHANGE ACT

The following table sets forth our directors, executive officers, promoters and control persons, their ages, and all offices and positions held. Directors are elected for a period of one year and thereafter serve until their successor is duly elected by the stockholders. Officers and other employees serve at the will of the Board of Directors.

Name	Age	Positions Held	Director Since
Michael J. Carroll	36	CEO/President, Interim CFO and Director	May 2003
Joel Arline	36	Director	November 2005

There is currently one vacancy on our board of directors that we expect to fill with an independent director. Our ability to locate an independent director may be unsuccessful because we do not have error and omission insurance for officers and directors. The above individuals will serve as officers and/or directors. A brief description of their positions, proposed duties and their background and business experience follows:

Michael J. Carroll. Prior to his appointment as CEO and President in November 2005, Mr. Carroll served as the Secretary, Treasurer and a Director of the Flooring Zone, Inc., since May 2003. He has held the same positions with The Flooring Zone of Georgia, Inc., since June 2000. In August 1997, Mr. Carroll founded Carroll Custom Homes, Inc., and since that time has served as its President. In that capacity, Mr. Carroll has been primarily responsible to

oversee the development and construction of residential housing and to manage purchasing, payroll and accounts payable. Mr. Carroll graduated from Georgia College and State University with a Bachelors Degree in Business Administration in 1992. Mr. Carroll is not a director of any other SEC reporting company.

Joel Arline. Mr. Arline is a Certified Public Accountant in Brunswick, GA. He is the President and Owner of Joel K. Arline, CPA, PC, an accounting firm he founded in 1997. Mr. Arline earned a BBA from Valdosta State University. The CPA firm owned by Mr. Arline, performs audit, review and compilation engagements and also performs tax preparation and consulting for its broad base of clients. Mr. Arline is not a director of any other SEC reporting company.

There are no family relationships among any of our officers and directors.

Compliance with Section 16(a) of the Exchange Act

Section 16(a) of the Exchange Act requires the directors, executive officers and persons who beneficially own more than 10% of any class of equity securities of an issuer that have been registered pursuant to Section 12 of the Exchange Act, to file initial reports of beneficial ownership and reports of changes in beneficial ownership of those securities with the Securities and Exchange Commission. As no class of our equity securities have been registered pursuant to Section 12 of the Exchange Act, our directors, executive officers and shareholders are not subject to the disclosure obligations of Section 16, and will not be until such time as we register a class of our equity securities pursuant to Section 12 of the Exchange Act.

Code of Ethics

While we are currently developing a code of ethics that will apply to our principal executive officer, principal financial officer and principal accounting officer or controller and to persons performing similar functions we have not yet completed drafting our code of ethics. The code of ethics will be designed to deter wrongdoing and to promote honest and ethical conduct, full, fair, accurate, timely and understandable disclosure, compliance with applicable laws, rules and regulations, prompt internal reporting of violations of the code and accountability for adherence to the code. We anticipate completion and adoption of a code of ethics during the upcoming fiscal year.

ITEM 10. EXECUTIVE COMPENSATION

EXECUTIVE COMPENSATION

The following table sets forth certain summary information concerning the compensation paid or accrued since the Company's inception on May 5, 2003 through December 31, 2005, (the end of the Registrant's last completed fiscal year).

Summary Compensation Table

Name and Principal Position	Annual Compensation Year	Salary	Bonus	Other Annual Compensation	Stock Awards	Long Term Awards Restricted Options/ SARs #	LTIP Payout ($)	Compens Payo Co
Michael Carroll, CEO	2005	$ -0-	$-0-	$-0-	$-0-	-0-	$-0-	
President, Interim CFO	2004	-0-	-0-	-0-	-0-	-0-	-0-	
and Director	2003	-0-	-0-	-0-	-0-	-0-	-0-	
Jimmy Lee, Former	2005	52,800	-0-	-0-	-0-	-0-	-0-	
CEO, President	2004	62,400	-0-	-0-	-0-	-0-	-0-	
and Director	2003	62,400	10,000	-0-	-0-	-0-	-0-	
Steven Nichols, Former	2005	59,608	-0-	-0-	-0-	-0-	-0-	
CFO and Vice	2004	60,950	6,700	-0-	-0-	-0-	-0-	
President	2003	59,800	2,500	-0-	-0-	-0-	-0-	

Employment Agreements with Executive Officers

We have no formal employment agreements with any of our executive officers.

Compensation of Directors

We have no arrangements pursuant to which your directors are compensated for any services provided as a director, or for committee participation or special assignments.

Termination of Employment and Change of Control Arrangement

There are no compensatory plans or arrangements, including payments to be received from us, with respect to any person named in cash compensation set forth above that would in any way result in payments to any such person because

of his resignation, retirement, or other termination of such person's employment with the company or its subsidiaries, or any change in control, or a change in the person's responsibilities following a changing in control of the Company.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The term "beneficial owner" refers to both the power of investment (the right to buy and sell) and rights of ownership (the right to receive distributions from the company and proceeds from sales of the shares). Inasmuch as these rights or shares may be held by more than one person, each person who has a beneficial ownership interest in shares is deemed the beneficial owners of the same shares because there is shared power of investment or shared rights of ownership.

The following table discloses the beneficial ownership of certain beneficial owners and management based on the number of shares we had outstanding as of June 20, 2006. As of June 20, 2006, we had 19,569.750 common shares outstanding.

Name and Address	Title of Class	Amount of Beneficial Ownership	% of Class
Michael Carroll 3219 Glynn Avenue Brunswick, Georgia 31520	Common	19,000,000	97%
Joel Arline 1606 Reynolds Streets Brunswick, Georgia 31520	Common	-0-	*
All officers and directors as a group (2 persons)		19,000,000	97%
TOTAL		19,000,000	97%

* Less than 1%

38

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In October 2003, we entered into an agreement with Mr. Carroll, whereby he agreed to extend us a line of credit. The interest rate on the line of credit is prime plus 1%. As of December 31, 2005, the outstanding balance on this line of credit was $115,000.

In October 2005, we obtained a line of credit for $200,000 from a related company owned by Mr. Carroll. The interest rate is prime plus 1%. At December 31, 2005, the outstanding balance for $200,000

We borrowed $27,000 against this line of credit during the fourth quarter of 2004. Subsequent to the year end, in February 2005, we paid $20,000 to Mr. Carroll to reduce the outstanding balance on this line of credit.

In August 2000, Mr. Carroll loaned Flooring Zone of Georgia, Inc., $275,000 pursuant to an unsecured note payable. This note bears interest at a rate of 10% per year. Under the terms of the note, we are required to make monthly installment payments of $4,565.33 though October 2008. As of September 30, 2004, the outstanding balance on this note was $192,012.

We believe that each of the above-described transactions was negotiated on terms at least as favorable to us as those available to us on an arms-length. As with the above transactions, all future material transactions entered into with related parties shall be on terms no less favorable to us than we can obtain from an unaffiliated third party on an arms-length basis and will be approved by a majority of our disinterested directors.

ITEM 13. EXHIBITS

Exhibits. The following exhibits are included as part of this report:

Exhibit 21.1	List of Subsidiaries
Exhibit 31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.1	Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.2	Certification of Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

ITEM 14. PRINCIPAL ACOUNTANT FEES AND SERVICES

Mantyla McReynolds has served as the Company's independent registered public accounting firm for the fiscal years ended December 31, 2005 and 2004. Principal accounting fees for professional services rendered for us by Mantyla McReynolds for the fiscal years ended December 31, 2005 and 2004, are summarized as follows:

	2005	2004
Audit	$ 28,392	$ 32,086
Audit related	-	-
Tax	-	-
All other	-	-
Total	$ 28,392	$ 32,086

Audit Fees. Audit fees were for professional services rendered in connection with the Company's annual financial statement audits and quarterly reviews of financial statements for filing with the Securities and Exchange Commission.

Board of Directors Pre-Approval Policies and Procedures. At its regularly scheduled and special meetings, the Board of Directors, in lieu of an established audit committee, considers and pre-approves any audit and non-audit services to be performed by the Company's independent accountants. The Board of Directors has the authority to grant pre-approvals of non-audit services.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf of the undersigned, thereunto duly authorized.

THE FLOORING ZONE, INC.

Dated: August 4, 2006

By: /s/ Michael Carroll

Michael Carroll, Chief Executive Officer, Interim Chief Financial Officer and Director

Dated: August 4, 2006

By: /s/ Joel Arline

Joel Arline, Director

40