NEXT INC/TN
Form 10QSB
April 14, 2004
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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 February 29, 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	**95-4675095**
(State or other jurisdiction of incorporation or organization)	**(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 April 14, 2004 was 14,295,461.

Transitional Small Business Disclosure Format (Check one): Yes ¨ No x

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Part I FINANCIAL INFORMATION

Item 1. Financial Statements

NEXT, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

	February 29, 2004 (unaudited)
Assets	
Current Assets:	
Cash	$ 132,906
Accounts receivable, net	3,076,675
Inventories	4,683,916
Prepaid expenses and other current assets	1,040,365
Deferred taxes, current	217,736
Total current assets	9,151,598
Property, plant and equipment, net	2,084,474
Goodwill	3,719,363
Other assets, net	844,229
Total Assets	$ 15,799,664
Liabilities and Shareholders Equity	
Current liabilities:	
Accounts payable	$ 1,377,696
Accrued expenses and other current liabilities	1,215,160
Short-term debt and current maturities	5,066,215
Total current liabilities	7,659,071
Long-term debt, less current maturities	3,394,524
Deferred taxes	180,065
Other non-current liabilities	371,000
Total liabilities	11,604,660
Commitments and contingencies	
Stockholders equity	4,195,004
Total Liabilities and Stockholders Equity	$ 15,799,664

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

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NEXT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended	
	February 28, 2003	February 29, 2004
	(unaudited)	(unaudited)
Net sales	$ 3,705,310	$ 3,805,421
Cost of sales	2,502,538	2,530,680
Gross profit	1,202,772	1,274,741
General administrative and selling expenses	1,146,105	1,216,373
Operating income	56,667	58,368
Interest	(109,251)	(117,571)
Other income	602	13,534
Income before income taxes	(51,982)	(45,669)
Benefit for income taxes	(18,845)	(18,268)
Net loss	(33,137)	(27,401)
Net loss per share, basic	$	$
Net loss per share, diluted	$	$
Weighted average shares outstanding, basic	11,132,948	14,089,174
Weighted average shares outstanding, diluted	11,132,948	15,072,174

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

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NEXT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	February 28, 2003	February 29, 2004
	(unaudited)	(unaudited)
Cash flows from operating activities:		
Net loss	$ (33,137)	$ (27,401)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	84,719	120,970
Noncash compensation	9,750	39,858
Bad debt expense	15,847	(2,179)
Deferred taxes	(18,845)	(18,268)
Changes in operating assets and liabilities:		
Accounts receivable	(188,808)	1,119,043
Inventories	(963,120)	424,580
Prepaid expenses	(41,007)	(498,913)
Other current assets	(5,859)	(52,107)
Accounts payable	(64,471)	(1,056,037)
Accrued expenses and other liabilities	(117,346)	(63,418)
Other non-current assets	(22,212)	
Total adjustments	(1,311,352)	13,529
Net cash used in operating activities	(1,344,489)	(13,872)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(145,411)	(55,763)
Cash received from proceeds on sale of asset		9,250
Cash paid for intangible assets		(40,411)
Net cash used in investing activities	(145,411)	(86,924)
Cash flows from financing activities:		
Revolving credit facility, net	1,098,641	(1,175,714)
Proceeds from loans and notes payable, bank	3,225,500	908,820
Repayments of long terms debt, loans and notes payable, bank	(2,775,276)	(82,364)
Cash paid for investment transaction		(13,470)
Net cash provided by/(used in) financing activities	1,548,865	(362,728)
Net increase (decrease) in cash	58,965	(463,524)
Cash, beginning of period	454,340	596,430
Cash, end of period	$ 513,305	$ 132,906
Supplemental Information:		
Cash paid during the period for interest	$ 95,699	$ 119,714

Non-Cash Investing and Financing Activities:		
Equity securities issued in payment of notes payable	$	$ 30,800

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

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NEXT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Operations of Company

Next, Inc., (NEXT or 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 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. See Note 8 of the Notes to Condensed Consolidated Financial Statements for a description of the Lil Fan acquisition.

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 February 29, 2004, and its results of operations and cash flows for the three months ended February 28, 2003 and February 29, 2004. Operating results for the three months ended February 29, 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 intercompany balances and transactions have been eliminated.

Customer Base & Credit Concentration

NEXT has, over the last three years, 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 substantive 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 network consisting of approximately 9,000 dealers, 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 three months ended February 29, 2004 the Company s sales to three customers comprised 52.5% of total sales, one of which was a not a customer in the three months ended February 28, 2003. During the three months ended February 28, 2003, the Company s sales to four customers comprised 67.3% of total sales. 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 estimate 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,

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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 February 29, 2004 consisted of the following:

Raw materials	$ 3,561,196
Work in process	389,250
Finished goods	733,470
	$ 4,683,916

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 February 29, 2004 are as follows:

Current asset:	
Accounts receivable reserves	$ 30,854
Net operating loss carryforwards	186,882
Current deferred tax asset	$ 217,736
Non-current liability:	
Goodwill and other intangibles	$ (30,684)
Adoption of tax depreciation method	210,749

Long-term deferred tax liability	$ 180,065

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5. Short Term and Long Term Debt

Short-term and long-term debt at February 29, 2004 consisted of the following:

	Short Term	Long Term
Revolving credit facility	$ 4,261,374	$
Notes payable	751,161	3,379,453
Capital lease obligations	53,680	15,071
Total	$ 5,066,215	$ 3,394,524

All of the Company s debt is collateralized by various assets and varying amounts guaranteed by its principal stockholders.

During the first quarter, the Company had an $8,000,000 revolving credit facility agreement with LaSalle Business Credit, LLC, (LaSalle) which expires on February 1, 2005. The Company may draw up to the sum of 85% of eligible accounts receivable, as defined, 60% of eligible raw materials as defined and $200,000 on finished goods inventory. In addition, the agreement provides for monthly payments of interest at a nationally published prime rate plus ..75% (4% was the published rate at February 29, 2004) and the Company must comply with certain financial and other covenants. Accounts receivable, inventory, certain personal assets and personal guarantees of certain of the Company s major stockholders collateralize borrowings under the facility.

On January 20, 2004, the Company entered into subordinated loan agreements with Next, Investors, LLC for $400,000 and First Federal Savings Bank for $500,000. The purpose of these loans was to provide working capital to be repaid out of a future equity infusion. The loans have a 4% and 6% interest rate and maturity dates of January 2006 and 2005, respectively. The First Federal component of $500,000 was paid out on April 9, 2004 from the proceeds of the investment by GCA Strategic Investment Fund Limited, which closed on April 8, 2004. See Note 9 of the Notes to Condensed Consolidated Financial Statements.

6. Stockholders Equity

Stockholders Equity is comprised of the following:

	At February 29, 2004 (unaudited)
Common stock, $.001 par value; 50,000,000 shares authorized, 14,082,461 shares issued and outstanding	$ 14,082
Additional paid in capital	2,971,035
Retained earnings	1,536,724
Unearned compensation	(326,837)

Total stockholders equity	$	4,195,004

The Company assumed the 2001 Next Stock Option Plan (the Next Plan) and all pre-existing options granted thereunder. 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 with and are subject to forfeiture should the grantee fail to be employed by the Company on the vesting date. The options issued in 2003 were all issued at market value and as such no expense was recorded. As of

February 29, 2004, 608,000 options were vested of the total 944,500 options granted. No options were vested as of February 28, 2003.

On July 9, 2003 the Company issued, pursuant to a Securities Purchase Agreement with certain 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 Company filed a registration statement under Form SB-2 to register 1,150,000 shares of the common stock pursuant to the above transaction and a second registration under Form SB-2 for the remaining 75,000 shares.

The significant shareholders of the Company, representing approximately 47.7% of total shares outstanding, have voluntarily entered into lock-up agreements whereby the shares owned by them are subject to a prohibition on transfer through May 1, 2006, that may be terminated on May 1, 2004 and every six months thereafter if all stockholders party to the lock-up agreements so decide.

7. 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 months ended February 28, 2003 and February 29, 2004 were calculated on the basis of the weighted average number of common shares outstanding during the three-month period, divided by the income available to common stockholders.

8. Acquisition of Lil Fan, Inc.

Pursuant to the terms of a Asset Purchase Agreement (the Agreement), dated as of July 31, 2003, by and among LFI Acquisition Corporation (a wholly owned subsidiary of the Company), Lil Fan, Inc., and Indiana corporation (Seller), Stan Howard & Associates, Inc. (SH&A) and Stanley R. Howard, the Company acquired all of the operating asset of Seller and the right to sell all items previously sold by SH&A.

Consideration for the acquisition was: $100,000 of cash, 180,000 shares of the Company s common stock, up to an additional 270,000 shares of the Company on a deferred basis (November 30, 2004, 2005, and 2006) pursuant to an earn-out arrangement, and the assumption of certain defined liabilities. The financial terms of the transaction were determined by negotiation between representatives of the Company, representatives of Seller and SH&A, and Stanley R. Howard. The cash portion of the purchase price was funded from cash generated from a sale of common stock and warrants to a group of private investors and from the operations of the Company. The Company continued to operate the business of Seller after the acquisition but has consolidated the production and financial functions to reduce cost and maximize resources.

The results of operations of Lil Fan are included in the condensed consolidated financial statements of the Company commencing August 1, 2003. The following pro-forma condensed combined statement of operations has been prepared as if the acquisition of Lil Fan was consummated as of the beginning of each periods presented herein. The Company has acquired the right to sell of all items sold by SH&A. The pro-forma results of operation are not necessarily indicative of the combined results that would have been achieved has the acquisition occurred at the beginning of the period, nor are they necessarily indicative of the results of operation that may occur in the future:

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	Pro-Forma Statement of Operations	
	Three Months Ended	
	February 28, 2003	February 29, 2004
	(unaudited)	(unaudited)
Net sales	$ 4,016,297	$ 3,805,421
Expenses	4,112,891	3,832,822
Net loss	(96,595)	(27,401)
Net loss per share, basic	$	$
Weighted average shares outstanding	11,492,948	14,089,174