ADVANCED MATERIALS GROUP INC
Form 10QSB
July 18, 2006

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

FORM 10-QSB

(Mark One)

|X| QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MAY 31, 2005

|_| TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NO. 0-16401

ADVANCED MATERIALS GROUP, INC.
(Exact name of registrant as specified in its charter)

NEVADA	33-0215295
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3303 LEE PARKWAY SUITE 105 DALLAS, TEXAS 75219
(Address of principal executive offices)(Zip code)

(972) 432-0602
(Registant's telephone number, including area code)

N/A

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

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 reports), and (2) has been subject to such filing requirements for the past 90 days. Yes |_| No |X|

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes |_| No |X|

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: Common Stock, $.001 par value, 12,116,000 shares outstanding as of July 1, 2006.

Transitional Small Business Disclosure Format (check one): Yes |_| No |X|

ADVANCED MATERIALS GROUP, INC.
FORM 10-QSB
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1.	Financial Statements:	1
	Consolidated Statements of Operations (unaudited) for the three and six months ended May 31, 2005 and May 31, 2004	1
	Consolidated Balance Sheets at May 31, 2005 (unaudited) and November 30, 2004	2
	Consolidated Statements of Cash Flows (unaudited) for the six months ended May 31, 2005 and, 2004	3
	Notes to Consolidated Financial Statements (unaudited)	4
ITEM 2.	Management's Discussion and Analysis or Plan of Operations	5
ITEM 3.	Controls and Procedures	9

PART II. OTHER INFORMATION

ITEM 1.	Legal Proceedings	9
ITEM 2.	Unregistered Sales of Equity Securities and Use of Proceeds	9
ITEM 3.	Defaults Upon Senior Securities	9
ITEM 4.	Submission of Matters to a Vote of Security Holders	9
ITEM 5.	Other Information	9
ITEM 6.	Exhibits	9
Signatures		11
Certifications		12

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

ADVANCED MATERIALS GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

THREE MONTHS ENDED		
MAY 31, 2005	MAY 31, 2004	MAY

Net sales	$ 2,056,863	$ 1,826,054	$
Cost of sales	1,615,073	1,565,272	
Gross profit	441,790	260,782	
Operating expenses:			
Selling, general and administrative	439,069	321,327	
Depreciation and amortization	50,298	36,764	
Total operating expenses	489,367	358,091	
Income (loss) from operations	(47,577)	(97,309)	
Other income (expense):			
Interest expense	(39,468)	(24,627)	
Impairment of fixed assets	--	(108,232)	
Gain on settlement	--	974,000	
Other, net	34,303	(27,574)	
Total other expenses, net	(5,165)	813,567	
Net income (loss)	$ (52,742)	$ 716,258	$
Basic and diluted earnings (loss) per common share	$ (0.01)	$ 0.07	$
Weighted Average Common Shares Outstanding:			
Basic	10,516,026	9,920,787	1
Diluted	10,516,026	10,179,830	1

See accompanying notes to consolidated financial statements

-1-

ADVANCED MATERIALS GROUP, INC.
CONSOLIDATED BALANCE SHEETS

	MAY 31, 2005 (UNAUDITED)
ASSETS	
Current assets:	
Cash and cash equivalents	$ 186,588
Accounts receivable, net	1,099,946
Inventories, net	801,451
Prepaid expenses and other	123,153
Total current assets	2,211,138
Property and equipment, net	488,876
Other assets	--

Total assets	$ 2,700,014

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Accounts payable	$ 724,301
Accrued liabilities	198,471
Restructuring reserve, current	12,656
Notes payable - related parties	200,000
Line of credit	840,234
Current portion of term loan	90,000
Current portion of capital lease obligations	36,740
Total current liabilities	2,102,402
Capital lease obligations, net of current portion	8,168
Term loan, net of current portion	110,500
Total liabilities	2,221,070
Commitments and contingencies	--
Stockholders' equity:	
Preferred stock-$.001 par value; 5,000,000 shares authorized; no shares issued and outstanding	--
Common stock-$.001 par value; 25,000,000 shares authorized; 10,516,026 shares issued and outstanding at May 31, 2005 and November 30, 2004	10,516
Additional paid-in capital	8,037,097
Accumulated deficit	(7,568,669)
Total stockholders' equity	478,944
Total liabilities and stockholders' equity	$ 2,700,014

-2-

ADVANCED MATERIALS GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	SIX
	MAY 31, 200
Cash flows from operating activities:	
Net loss	$(262,217)
Adjustments to reconcile net loss to net cash used in operating activities	
Depreciation and amortization	216,433
Provision for obsolete inventory	--
Restructuring reserve adjustment	
Non-cash compensation	--
Impairment of fixed assets	
Gain on settlement	
Changes in operating assets and liabilities:	
Accounts receivable	93,257
Inventories	(110,500)
Prepaid expenses and other	40,291
Accounts payable and accrued liabilities	94,005
Restructuring reserve	(12,656)

Net cash provided by operating activities	58,613
Cash flows from investing activities:	
Purchases of property and equipment	(7,408)
Net cash used in investing activities	(7,408)
Cash flows from financing activities:	
Sale of common stock	--
Exercise of common stock options	--
Net borrowings under line of credit	154,264
Proceeds from issuance of debt	--
Payments on debt	(74,170)
Net cash provided by financing activities	80,094
Net change in cash and cash equivalents	131,299
Cash and cash equivalents, beginning of period	55,289
Cash and cash equivalents, end of period	$ 186,588
Supplemental disclosures of cash flow information	
Cash paid during the period for:	
Interest	$ 73,489
Income taxes	$ --

See accompanying notes to consolidated financial statements

ADVANCED MATERIALS GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1) BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission and therefore do not include all information and footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America.

The unaudited consolidated financial statements do, however, reflect all adjustments, consisting of only normal recurring adjustments, which are, in the opinion of management, necessary to state fairly the financial position as of May 31, 2005 and November 30, 2004 and the results of operations and cash flows for the related interim periods ended May 31, 2005 and May 31, 2004. However, these results are not necessarily indicative of results for any other interim period or for the year. It is suggested that the accompanying consolidated financial statements be read in conjunction with the Company's audited consolidated financial statements and accompanying notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2004.

The Company's consolidated financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred continued net losses. At May 31, 2005, the Company had limited cash reserves and was not in compliance with certain financial covenant ratios pertaining to its line of credit, and therefore is in technical default under the compliance provisions of the line of credit and term loan. This violation was cured in October 2005. Management has implemented a plan to reduce expenses and improve sales. The Company has altered its focus and will now be concentrating on securing proprietary products primarily for the medical and consumer industry. The objective is to create advanced designs, using current materials. These products will be pursued through aggressive product development and the licensing of existing patented products or technology. These new products are expected to have higher profit margins and be less subject to competition. There can be no assurances that the Company will be successful in completing these critical tasks. If the Company is unable to successfully complete these critical tasks, it may be forced to significantly reduce, restructure or cease its operations and/or liquidate inventory at amounts below current carrying value to generate the necessary working capital to fund its operations, and if necessary, seek other remedies available to the Company including protection under the bankruptcy laws. As a result of these and other factors, the Company's independent certified registered public accounting firm, Katherine Fang, LLP, indicated in their report on the 2004 consolidated financial statements, that there is substantial doubt about the Company's ability to continue as a going concern.

The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

Principles of Consolidation

The consolidated financial statements include the accounts of Advanced Materials Group, Inc. and its wholly owned subsidiary, Advanced Materials, Inc. and Advanced Materials, Ltd. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 materially from those estimates.

2) LOSS PER SHARE

The Company has adopted the provisions of Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("SFAS 128"). SFAS 128 requires the presentation of basic and diluted net income per share. Basic earnings per share exclude dilution and are computed by dividing net income by the weighted average of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that would occur if

securities or other contracts to issue common stock were exercised or converted into common stock. Potential common share equivalents including stock options and warrants have been excluded for the three-month periods ended May 31, 2005 and May 31, 2004, as their effect would be antidilutive.

There were 2,556,000 and 1,747,250 potentially dilutive options and warrants outstanding at May 31, 2005 and May 31, 2004, respectively, that were not included in the computation of the net loss per share because they would be anti-dilutive.

3) STOCK BASED COMPENSATION

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148, "Accounting for Stock-Based Compensation -- Transition and Disclosure", which amended FAS No. 123, "Accounting for Stock-Based Compensation." The new standard provides alternative methods of transition for a voluntary change to the fair market value based method for accounting for stock-based employee compensation. Additionally, the statement amends the disclosure requirements of FAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. In compliance with FAS No. 148, the Company has elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation plan as defined by APB No. 25.

The following table represents the effect on net income and earnings per share if the Company had applied the fair value based method and recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", to stock-based employee compensation. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information follows:

	THREE MONTHS ENDED MAY 31,		
	2005	2004	2
Net income (loss) available to common stockholders	$ (52,742)	$ 716,258	$ (2
Plus: Stock-based employee compensation included in reported net income (loss)	--	--	
Less: Total stock-based employee compensation determined using fair value based method	(9,378)	(41,105)	(
Pro forma net income (loss) available to common stockholders	(62,120)	675,153	(2
Net income (loss) per common share - as reported:			
Basic	(0.01)	0.07	
Diluted	(0.01)	0.07	
Net income (loss) per common share - pro forma:			
Basic	(0.01)	0.07	
Diluted	(0.01)	0.07	

4) INVENTORIES

Inventories are stated at the lower of cost (determined on the first-in, first-out method) or market. Inventories consisted of the following:

	MAY 31, 2004
	(UNAUDITED)
Raw Materials	$ 352,359
Work-in-process	149,270
Finished Goods	320,038
Less allowance for obsolete inventory	(20,216)
	$ 801,451

5) CONTINGENT LIABILITIES

Material legal proceedings to which the Company is a party are discussed in Part 1, Item 3, in the Company's latest Annual Report on Form 10-K and in Part II, Item 1 of this Form 10-QSB.

ITEM 2 -MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

The following discussion should be read in conjunction with the unaudited consolidated financial statements and the related notes that appear elsewhere in this report.

-5-

This document contains forward-looking statements that involve risks and uncertainties that could cause the results of the Company and its consolidated subsidiaries to differ materially from those expressed or implied by such forward-looking statements. These risks include the timely development, production and delivery of new products; the challenge of managing asset levels, including inventory and trade receivables; the difficulty of keeping expense growth at modest levels while increasing revenues and other risks described from time to time in the Company's filings with the Securities and Exchange Commission, including but not limited to the Annual Report on Form 10-K for the year ended November 30, 2004 and in "Factors That Could Affect Future Results" below.

Forward-looking statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated or expected.

The Company's condensed consolidated financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company incurred a net loss of $52,742 in the three-month period ended May 31, 2005 and a net loss of $262,217 in the six-month period ended May 31 , 2005, the Company had limited cash reserves and was not in compliance with certain financial covenant ratios pertaining to its line of credit, and therefore is in

technical default under the compliance provisions of the line of credit and term loan. This violation was cured in October 2005. Management has implemented a plan to reduce expenses and improve sales. The Company has altered its focus and will now be concentrating on securing proprietary products primarily for the medical and consumer industry. The objective is to create advanced designs, using current materials. These products will be pursued through aggressive product development and the licensing of existing patented products or technology. These new products are expected to have higher profit margins and be less subject to competition. There can be no assurances that the Company will be successful in completing these critical tasks. If the Company is unable to successfully complete these critical tasks, it may be forced to significantly reduce, restructure or cease its operations and/or liquidate inventory at amounts below current carrying value to generate the necessary working capital to fund its operations, and if necessary, seek other remedies available to the Company including protection under the bankruptcy laws. As a result of these and other factors, the Company's independent certified registered public accounting firm, Katherine Fang, LLP, indicated in their report on the 2004 consolidated financial statements, that there is substantial doubt about the Company's ability to continue as a going concern.

RESULTS OF OPERATIONS
FY 05 CURRENT THREE MONTHS VERSUS FY 04

Net sales for the quarter ended May 31, 2005 were $2,056,863 versus $1,826,054 for the same period of fiscal 2004, an increase of $230,809 or 13%. Revenues from the Singapore strategic manufacturing venture declined to $144,107 in the three-month period ended May 31, 2005 from $179,708 in the comparable period in 2004. Revenues from U.S. operations increased to $1,912,756 in the second quarter of 2005 from $1,646,346 in 2004.

The increase in sales for the U.S. operations are due to both increased sales prices and higher sales volumes. The Company has begun to shift its primary focus to generating its own proprietary opportunities with both its existing customer base as well as new prospects in order to build a more competitive base of business in the United States. In is anticipated that sales will continue to increase as customer contracts are signed and new business is added.

Cost of sales for the quarters ended May 31, 2005 and May 31, 2004 were $1,615,073 and $1,565,272, respectively. Cost of sales as a percentage of net sales was 79% for the second quarter of fiscal 2005, compared to 86% for the second quarter of fiscal 2004. The Company's gross profit percentage was 21% in 2005 period, compared to 14% in the 2004 period. After the 2nd fiscal quarter 2004 the company significantly reduced manufacturing costs. During the 2nd quarter of 2004, manufacturing costs were about 23%; the 2nd fiscal quarter of 2005 costs were about 16%, which is contributed to the gross profit percentage increase from 14% to 23% in the second quarter of fiscal 2005.

Selling, general and administrative expenses for the second quarter of fiscal 2005 and 2004 were $439,069 and $321,327, respectively, an increase of $117,742 or 37%. The reason for this increase was primarily due to the legal expenses associated with the tax notice received from the IRAS to research fully the issue.

Interest expense for the second quarter of fiscal 2005 and 2004 was $39,468 and $24,627, respectively. Interest expense relates primarily to bank borrowings and is not expected to fluctuate significantly in the near future.

Net loss for the second quarter of fiscal 2005 was $52,742, compared to net income of $716,258 for the second quarter of fiscal 2004. Basic and diluted loss per share for the second quarter of fiscal 2005 was $0.01 per share, compared to net income of $0.07 per share for the second quarter of fiscal 2004.

FY 05 CURRENT SIX MONTHS VERSUS FY 04

Net sales for the six-month period ended May 31, 2005 were $4,023,929 versus $3,840,665 for the same period of fiscal 2004, an increase of $183,264 or 5%. Revenues from the Singapore strategic manufacturing venture declined to $253,921 in the six-month period ended May 31, 2005 from $371,319 in the comparable period in 2004. Revenues from U.S. operations increased to $3,770,008 in the six-month period ended May 31, 2005 from $3,469,346 in 2004.

The increase in sales for the U.S. operations are due to both increased sales prices and higher sales volumes.

The lower sales in Singapore are primarily attributable to an amendment to the Company's manufacturing agreement in Singapore with Foamex Asia ("Foamex") to change the vendor of record for the customer supplied under the agreement from the Company to Foamex effective July 17, 2003. Although this change does not affect the Company's share of the profitability under the agreement, it does cause a significant reduction in its reported revenues. Previously, the Company purchased the raw materials for the production of product and billed the end customer and therefore recognized the gross sales and cost of sales on its financials. Under the amended agreement, it no longer purchases the raw materials or bills the end customer and only recognizes its portion of profit as revenue. Management believes this change has been beneficial to the Company as it stills maintains a share of the profits from the Singapore agreement, while it has significantly reduced its capital requirements since it no longer needs to purchase raw materials several months in advance of realizing sales.

Cost of sales for the six-month periods ended May 31, 2005 and May 31, 2004 were $3,235,525 and $3,151,062, respectively. The Company's gross profit percentage was 20% in 2005 period, compared to 18% in the 2004 period. The increase in gross profit percentage for the second quarter of 2005 was primarily due to the change in the Singapore agreement noted above. The remaining improvement in the gross profit percentage is due to the Company's discontinuing certain low margin sales, and lower labor and overhead costs due to the optimizing of manufacturing processes.

Selling, general and administrative expenses for the six-month periods ended May 31, 2005 and 2004 were $915,366 and $760,152, respectively, an increase of $155,214 or 20%. This increase was due primarily to abnormal legal expenses which described below and corporate-office relocation expenses.

Interest expense for the six-month periods ended May 31, 2005 and 2004 was $73,489 and $47,587, respectively. Interest expense relates primarily to bank borrowings and is not expected to fluctuate significantly in the near future.

Net loss for the six-month period ended May 31, 2005 was $262,217, compared to net income of $647,043 for the same period of fiscal 2004. Basic and diluted income (loss) per share for the six-month period ended May 31, 2005 was $(0.02) per share, compared to $0.07 per share for the same period of fiscal 2004.

Net income for six- month period of 2004 includes gain on settlement of litigation of $974,000 and the reversal of a restructuring reserve of $84,032.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were $186,588 at May 31, 2005, compared with $55,289 at November 30, 2004. Operating activities provided $58,613 of cash during the six-month period of fiscal 2005, compared with $19,476 in the corresponding

period of fiscal 2004. The cash provided by operating activities in 2005 resulted primarily from a decrease in accounts receivable, and an increase in accounts payable and accrued liabilities, offset by an increase in inventory of $93,257 and $94,005 and $110,500, respectively.

Capital expenditures were $7,408 for the six months ended May 31, 2005, compared to $1,000 for the corresponding period in fiscal 2004. The Company has instituted a Company-wide program to reduce non-essential capital expenditures that are not specifically focused on revenue growth.

The Company uses short- and long-term borrowings to supplement internally generated cash flow. Activity related to short- and long-term borrowings in the six-months ended May 31, 2005 resulted in cash provided by financing activities of $80,094.

At May 31, 2005, the Company was not in compliance with certain financial covenant ratios pertaining to its line of credit, and therefore is in technical default under the compliance provisions of the line of credit and term loan. In September of 2005, the Company renegotiated the terms of these debt instruments, reducing the line of credit from $3.75 million to $1.5 million and extending the term of the term loan through October 1, 2006 with monthly principal payments of $7,500 and the remainder due on October 1, 2006. Under the new agreement, the line of credit and term loan bear interest at Prime plus 1.5% and Prime plus 2.0%, respectively. As a result of the new agreement, the Company was able to cure its debt covenant violations.

FACTORS THAT COULD AFFECT FUTURE RESULTS

BANKING - The Company has incurred losses from operations The Company has incurred continued net losses. At May 31, 2005, the Company had limited cash reserves and was not in compliance with certain financial covenant ratios pertaining to its line of credit, and therefore is in technical default under the compliance provisions of the line of credit and term loan. This violation was cured in October 2005. The curing of this default along with the revised terms of the lending agreement result in reduced administrative and borrowing fees.

COMPETITION - The Company encounters aggressive competition in all areas of its business. It has numerous competitors, ranging from several comparable-size companies to many relatively small companies. The majority of the competitors are private, closely held companies. There is also the risk that a supplier to the Company could become a competitor. The Company competes primarily on the basis of performance, price, quality and customer service. Product life cycles are short, with numerous small one-time customer orders. To remain competitive, the Company must be able to quickly develop new products and enhance existing products in response to customer demands. In some of its markets, the Company may not be able to successfully compete against current and future competitors, and the competitive pressures faced could harm the Company's business and prospects.

NEW PRODUCT INTRODUCTIONS - If the Company cannot continue to rapidly develop and manufacture innovative products that meet customer requirements for performance, price, quality and customer service, it may lose market share and future revenue and earnings may suffer. The process of developing new products and corresponding manufacturing processes is complex and uncertain. The customer decision-making process can be lengthy and some raw materials have extremely long lead times. These circumstances often lead to long delays in new product introductions. After a product is developed, the Company must be able to manufacture sufficient volumes quickly at low enough costs. To do this it must

accurately forecast volumes and mix of products. Customer orders have also been subject to dramatic swings from customer provided forecasts. Thus, matching customers' demand and timing for particular products makes the process of planning production and managing inventory levels increasingly difficult.

SHORT PRODUCT LIFE CYCLES - The short life cycles of many of the Company's products pose a challenge to the Company's ability to effectively manage the transition from existing products to new products. If the Company does not manage the transition effectively, future revenue and earnings could suffer. Among the factors that make a smooth transition from current products to new products difficult are delays in the customer decision-making process, development of manufacturing processes, long lead times for the delivery of raw materials and variations in product costs. The Company's future revenues and earnings could also suffer due to the timing and introduction of new product offerings that compete directly or indirectly with its customers' products and new product offerings by its competitors.

RELIANCE ON SUPPLIERS - The Company's manufacturing operations depend on its suppliers' ability to deliver quality raw materials and components in time for the Company to meet critical manufacturing and distribution schedules. The Company sometimes experiences a short supply of certain raw materials as a result of supplier out-of-stock situations or long manufacturing lead times. If shortages or delays exist, the Company's future operating results could suffer. Furthermore, it may not be able to secure enough raw materials at reasonable prices to manufacture new products in the quantities required to meet customer demand. Sudden or large raw materials price increases could also cause future operating results to suffer if the Company is not able to increase its sales prices to account for the materials price increases.

EARTHQUAKE - The corporate offices and manufacturing division in California are located near major earthquake faults. The ultimate impact on the Company and its general infrastructure is unknown, but operating results could be materially affected in the event of a major earthquake. The Company is predominantly uninsured for losses and interruptions caused by earthquakes.

ENVIRONMENTAL - Some of the Company's operations use substances regulated under various federal, state and international laws governing the environment. It is the Company's policy to apply strict standards for environmental protection to sites inside and outside the U.S., even when not subject to local government regulations. The Company has not been notified of any environmental infractions.

PROFIT MARGIN - The Company's profit margins vary somewhat among its products. Consequently, the overall profitability in any given period is partially dependent on the product and customer mix reflected in that period's net sales.

STOCK PRICE - The Company's stock price, like that of any other small-cap company, can be volatile. Some of the factors that can affect the stock price are:

- The Company's, its customer's or its competitor's announcement of new or discontinued products,
- Quarterly increases or decreases in earnings,
- Changes in revenue or earnings estimates by the investment community, and
- Speculation in the press or investment community.

General market conditions and domestic or international macroeconomic factors unrelated to the Company's performance may also affect the stock price. For these reasons, investors should not rely on recent trends to predict future stock prices or financial results. In addition, following periods of volatility in a company's securities, securities class action litigation against a company is sometimes instituted. This type of litigation could result in substantial costs and the diversion of management time and resources.

EARNINGS FLUCTUATIONS - Although management believes the Company has products and resources needed for successful results, it cannot reliably predict future revenue and margin trends. Actual trends may cause it to adjust its operations, which could cause period-to-period fluctuations in earnings.

ITEM 3 - CONTROLS AND PROCEDURES

The Company's Chief Executive Officer (the Company's principal executive officer and principal financial officer), has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the period ended May 31, 2005, the period covered by this Quarterly Report on Form 10-QSB. Based upon that evaluation, the Company's principal Chief Executive Officer has concluded that the disclosure controls and procedures were effective as of May 31, 2005 to provide reasonable assurance that material information relating to the Company is made known to the CEO.

There were no changes in the Company's internal control over financial reporting that occurred during the period ended May 31, 2005 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

NONE

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

NONE

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

At May 31, 2005, the Company was not in compliance with certain financial covenant ratios pertaining to its line of credit, and therefore is in technical default under the compliance provisions of the line of credit and term loan. In September of 2005, the Company renegotiated the terms of these debt instruments, reducing the line of credit from $3.75 million to $1.5 million and extending the term of the term loan through October 1, 2006 with monthly principal payments of $7,500 and the remainder due on October 1, 2006. Under the new agreement, the line of credit and term loan bear interest at Prime plus 1.5% and Prime plus 2.0%, respectively. As a result of the new agreement, the Company was able to cure its debt covenant violations.

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

NONE

ITEM 5. OTHER INFORMATION.

NONE

ITEM 6. EXHIBITS

(a) Exhibits.

EXHIBITS	DESCRIPTION
31.1	Certifications Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: July 18, 2006 ADVANCED MATERIALS GROUP, INC.

By: /s/ William G. Mortensen

William G. Mortensen
President and Chief Financial Officer