ADVANCED MATERIALS GROUP INC
Form 10QSB
August 22, 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 FEBRUARY 28, 2006

|_| 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, 12,116,026 shares outstanding as of June 12, 2006.

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

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

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

	THREE MONTHS ENDED	
	FEBRUARY 28, 2006	FEBRUARY 28, 2005
Net sales	$ 2,375,337	$ 1,967,066
Cost of sales	1,700,786	1,620,452
Gross profit	674,551	346,614
Operating expenses:		
Selling, general and administrative	464,727	476,297
Depreciation and amortization	26,769	50,144
Total operating expenses	491,496	526,441
Income (loss) from operations	183,055	(179,827)
Other income (expense):		
Interest expense	(41,884)	(34,021)
Other, net	11,522	4,373
Total other income (expense), net	(30,362)	(29,648)
Net income (loss)	$ 152,693	$ (209,475)
Basic and diluted net income (loss) per share	$ 0.01	$ (0.02)
Weighted average common shares outstanding:		
Basic	12,116,026	10,516,026
Diluted	12,140,783	10,516,026

See accompanying notes to consolidated financial statements

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ADVANCED MATERIALS GROUP, INC.
CONSOLIDATED BALANCE SHEETS

	FEBRU 2006 (U
ASSETS	
Current assets:	
Cash and cash equivalents	$
Accounts receivable	
Inventories, net	
Prepaid expenses and other	
Total current assets	
Property and equipment, net	
Other assets	
Total assets	$
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	$
Accrued liabilities	
Notes payable - related parties	
Line of credit	
Current portion of term loan	
Current portion of capital lease obligations	
Total current liabilities	
Capital lease obligations, net of current portion	
Term loan, net of current portion	
Total liabilities	
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; 12,116,026 shares issued and outstanding at February 28, 2006 and November 30, 2005	
Additional paid-in capital	
Accumulated deficit	(
Total stockholders' equity	
Total liabilities and stockholders' equity	$

See accompanying notes to consolidated financial statements

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

	T
	FEBRUARY 28,
Cash flows from operating activities:	
Net income (loss)	$ 152
Adjustments to reconcile net income (loss) to net cash provided by operating activities	
Depreciation and amortization	62
Changes in operating assets and liabilities:	
Accounts receivable	236
Inventories	89
Prepaid expenses and other	66
Accounts payable and accrued liabilities	(575
Restructuring reserve	
Net cash provided by (used in) operating activities	33
Cash flows from investing activities:	
Purchases of property and equipment	(20
Net cash used in investing activities	(20
Cash flows from financing activities:	
Net borrowings under line of credit	84
Repayments under term loan	(25
Repayments of other long-term obligations	(29
Net cash provided by (used in) financing activities	29
Net change in cash and cash equivalents	42
Cash and cash equivalents, beginning of period	407
Cash and cash equivalents, end of period	449
Supplemental disclosures of cash flow information	
Cash paid during the period for:	
Interest	$ 41
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 February 28, 2006 and the results of operations and cash flows for the interim periods ended February 28, 2006 and February 28, 2005. 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-KSB for the fiscal year ended November 30, 2005.

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) EARNINGS (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 February 28, 2006 and February 28, 2005, as their effect would be antidilutive.

There were 686,000 and 2,556,000 potentially dilutive options and warrants outstanding at February 28, 2006 and February 28, 2005, respectively, that were not included in the computation of the net income (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 EN	
	FEBRUARY 28, 2006	FEB
Net income (loss) available to common shareholders	$ 152,693	$
Plus: Stock-based employee compensation expense included in reported net income (loss)	--	
Less: Total stock-based employee compensation determined using fair value based method	(4,750)	
Pro forma net income (loss) available to common stockholders	$ 147,943	$
Net income (loss) per common share - basic and diluted - as reported	$ 0.01	$
Net income (loss) per common share - basic and diluted - pro forma	$ 0.01	$

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:

	FEBRUARY 28, 2006	NOVEMBER 30, 2005

	(UNAUDITED)	
Raw Materials	$ 441,202	$ 479,206
Work-in-process	75,272	150,763
Finished Goods	513,822	489,988
Less allowance for obsolete inventories	(34,900)	(34,900)
	$ 995,396	$ 1,085,057

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.

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-KSB for the year ended November 30, 2005 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. Advanced Materials Group, Inc. undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

GENERAL

As of February 28, 2006, we had working capital of $875,965 compared to working capital of $707,958 at November 30, 2005. The change is primarily related our reduction of outstanding accounts payable and accrued liabilities by $467,511 and $108,460, respectively, over the three month period. The decrease in accounts payable and accrued liabilities is offset by additional borrowings under our line of credit of $84,990. Current assets have decreased $349,373 during the three month period ended February 28, 2006 primarily as a result of decreases in accounts receivable and inventories, offset by an increase in cash.

RESULTS OF OPERATIONS THREE MONTHS ENDED FEBRUARY 28, 2006 COMPARED TO THE THREE MONTHS ENDED FEBRUARY 28, 2005

Net sales for the quarter ended February 28, 2006 were $2,375,337 versus $1,967,066 for the same period of fiscal 2005, an increase of $408,271 or 21%. Revenues from the Singapore strategic manufacturing venture increased to $160,968 in the three-month period ended February 28, 2006 from $109,814 in the comparable period in 2005. Revenues from U.S. operations increased to $2,214,369 in the first quarter of 2006 from $1,857,252 in 2005.

The increase in sales for U.S. operations is due to both increased sales prices and higher sales volumes. The Company is shifting 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.

Cost of sales for the quarters ended February 28, 2006 and February 28, 2005 were $1,700,786 and $1,620,452, respectively. The Company's gross profit percentage was 28% in the 2006 period, compared to 18% in the 2005 period. The Company continues to negotiate supply contracts with our suppliers to guard against changing market conditions which would increase costs. The Company also continues to buy in bulk quantities to achieve lower costs.

Selling, general and administrative expenses for the first quarter of fiscal 2006 and 2005 were $464,727 and $476,297, respectively, a decrease of $11,570 or 2%.

Interest expense for the first quarter of fiscal 2006 and 2005 was $41,884 and $34,021, respectively. Interest expense relates primarily to bank borrowings and is not expected to fluctuate significantly in the near future.

Net income for the first quarter of fiscal 2006 was $152,693, compared to a net loss of $209,475 for the first quarter of fiscal 2005. Basic and diluted net income per share for the first quarter of fiscal 2006 was $0.01 per share, compared to a net loss of $.02 per share for the first quarter of fiscal 2005.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were $449,125 at February 28, 2006, compared with $407,039 at November 30, 2005. Operating activities provided $33,097 of cash during the first quarter of fiscal 2006, compared with $132,178 in the corresponding period of fiscal 2005. The cash provided by operating activities in the first quarter of 2006 resulted primarily from a decrease in accounts receivable, inventories and prepaid expenses and other, offset by a decrease in accounts payable and accrued liabilities of $236,901, $89,661, $66,999 and $575,971, respectively.

Capital expenditures were $20,694 for the three months ended February 28, 2006, compared to $4,129 for the corresponding period in fiscal 2005. 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 three-months ended February 28, 2006 resulted in cash provided in financing activities of $9,683 compared to cash used of $29,349 in the same period of 2005.

FACTORS THAT COULD AFFECT FUTURE RESULTS

BANKING - The Company continues to improve the balance sheet through the realization of positive earnings quarter over quarter. This has allowed the Company to seek out conventional bank financing other than the current asset based credit facility in place. The Company is working towards moving to conventional bank line of credit by the fourth quarter of 2006.

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.

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 AM manufacturing division in California is 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 and President/Chief Financial Officer (the Company's principal executive officer and principal financial officer), have 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 February 28, 2006, the period covered by this Quarterly Report on Form 10-QSB. Based upon that evaluation, the Company's principal Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures were effective as of February 28, 2006 to provide reasonable assurance that material information relating to the Company is made known to the CEO and CFO.

There were no changes in the Company's internal control over financial reporting that occurred during the period ended February 28, 2006 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.

NONE

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

NONE

ITEM 5. OTHER INFORMATION.

NONE

ITEM 6. EXHIBITS

(a) Exhibits.

EXHIBIT NO.	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
31.2	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
32.2	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: August 22, 2006 ADVANCED MATERIALS GROUP, INC.

By: /s/ William G. Mortensen
William G. Mortensen
President and Chief Financial Officer