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ADVANCED MATERIALS GROUP INC
Form 10QSB
July 18, 2006

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

FORM 10-QSB

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED AUGUST 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
(State or other jurisdiction of
incorporation or organization)

33-0215295
(I.R.S. Employer
Identification No.)

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

(972) 432-0602
(Registrant'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

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

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

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

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

	THREE MONTHS ENDED		NINE
	AUGUST 31, 2005	AUGUST 31, 2004	AUGUST 3 2005
Net sales	\$ 1,943,450	\$ 2,016,298	\$ 5,967,
Cost of sales	1,550,911	1,510,925	4,786,
Gross profit	392,539	505,373	1,180,
Operating expenses:			
Selling, general and administrative	344,344	401,192	1,259,
Depreciation and amortization	39,214	50,180	139,
Total operating expenses	383,558	451,372	1,399,
Income (loss) from operations	8,981	54,001	(218,
Other income (expense):			
Interest expense	(39,982)	(34,451)	(113,
Impairment of fixed assets	--	--	
Gain on settlement	--	--	
Other, net	51,358	16,011	90,
Total other income (expenses), net	11,376	(18,440)	(23,
Net income (loss)	\$ 20,357	\$ 35,561	\$ (241,
Basic and diluted earnings (loss) per common share	\$ 0.00	\$ 0.00	\$ (0
Weighted Average Common Shares Outstanding:			
Basic	10,932,693	10,469,730	10,654,
Diluted	10,941,264	10,955,303	10,654,

See accompanying notes to consolidated financial statements

ADVANCED MATERIALS GROUP, INC.
CONSOLIDATED BALANCE SHEETS

AUGUST 31, NOVEMBER 30,
2005 (UNAUDITED) 2004

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ASSETS		
Current assets:		
Cash and cash equivalents	\$ 140,501	\$ 55,289
Accounts receivable	1,071,104	1,193,203
Inventories, net	1,094,734	690,951
Prepaid expenses and other	174,699	162,776
	-----	-----
Total current assets	2,481,038	2,102,219
Property and equipment, net	424,205	697,901
Other assets	80,965	668
	-----	-----
Total assets	\$ 2,986,208	\$ 2,800,788
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 874,285	\$ 582,871
Accrued liabilities	149,198	245,896
Restructuring reserve, current	12,656	25,312
Notes payable - related parties	100,000	200,000
Line of credit	875,591	685,970
Current portion of term loan	90,000	90,000
Current portion of capital lease obligations	41,484	45,275
	-----	-----
Total current liabilities	2,143,214	1,875,324
Capital lease obligations, net of current portion	5,860	18,803
Term loan, net of current portion	88,000	165,500
	-----	-----
Total liabilities	2,237,074	2,059,627
	-----	-----
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; 11,766,026 and 10,516,026 shares issued and outstanding at August 31, 2005 and November 30, 2004, respectively	11,766	10,516
Additional paid-in capital	8,285,846	8,037,097
Accumulated deficit	(7,548,478)	(7,306,452)
	-----	-----
Total stockholders' equity	749,134	741,161
	-----	-----
Total liabilities and stockholders' equity	\$ 2,986,208	\$ 2,800,788
	=====	=====

See accompanying notes to consolidated financial statements

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(UNAUDITED)

	NINE MONTHS EN	
	AUGUST 31,	AU
	2005	
	-----	---
Cash flows from operating activities:		
Net income (loss)	\$ (241,860)	\$
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	295,957	
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	122,099	
Inventories	(403,783)	
Prepaid expenses and other assets	(92,220)	
Accounts payable and accrued liabilities	194,716	(
Deferred compensation	--	(
Restructuring reserve	(12,656)	
	-----	---
Net cash used in operating activities	(137,747)	(
	-----	---
Cash flows from investing activities:		
Purchases of property and equipment	(22,261)	(
	-----	---
Net cash used in investing activities	(22,261)	(
	-----	---
Cash flows from financing activities:		
Sale of common stock	249,833	
Exercise of common stock options	--	
Net borrowings under line of credit	189,621	
Proceeds from issuance of debt	--	
Payments on debt	(194,234)	(
	-----	---
Net cash provided by financing activities	245,220	
	-----	---
Net change in cash and cash equivalents	85,212	
Cash and cash equivalents, beginning of period	55,289	
	-----	---
Cash and cash equivalents, end of period	\$ 140,501	\$
	=====	==
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	\$ 113,470	\$
	=====	==
Income taxes	\$ --	\$
	=====	==

See accompanying notes to consolidated financial statements

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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 August 31, 2005 and November 30, 2004 and the results of operations and cash flows for the related interim periods ended August 31, 2005 and August 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. At August 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 August 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

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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.

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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 August 31, 2005 and August 31, 2004, as their effect would be antidilutive.

There were 2,436,000 and 1,176,000 potentially dilutive options and warrants outstanding at August 31, 2005 and August 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

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information follows:

	THREE MONTHS ENDED AUGUST 31,		NINE MONTH AUGUST
	2005	2004	2005
Net income (loss) available to common stockholders	\$ 20,357	\$ 35,561	\$ (241,860)
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)	(30,040)	(18,755)
Pro forma net income (loss) available to common stockholders	10,979	5,521	(260,615)
Net income (loss) per common share - as reported:			
Basic	0.00	0.00	(0.02)
Diluted	0.00	0.00	(0.02)
Net income (loss) per common share - pro forma:			
Basic	0.00	0.00	(0.02)
Diluted	0.00	0.00	(0.02)
	=====	=====	=====

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:

	AUGUST 31, 2004	NOVEMBER 30, 2004
	(UNAUDITED)	
Raw Materials	\$ 440,237	\$ 348,738
Work-in-process	140,747	45,276
Finished Goods	513,750	317,154
	-----	-----
Less allowance for obsolete inventory		(20,217)
	-----	-----
	\$ 1,094,734	\$ 690,951
	=====	=====

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5) STOCKHOLDERS EQUITY

In August, 2005, ADMG issued to each of the Lenawee Trust and Plus Four Private Equities, L.P. 625,000 shares of ADMG's common stock for \$0.20 per share (\$125,000 each). The Lenawee Trust is an affiliate of Timothy R. Busch, the Chairman of ADMG's Board of Directors.

6) DEBT

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At August 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.

7) 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.

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 August 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 generated net income of \$20,357 and \$35,561 in the three-month periods ended August 31, 2005 and 2004, respectively and a net loss \$241,860 and net income of \$682,605 in the nine-month periods ended August 31, 2005 and 2004, respectively. At August 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 August be forced to significantly reduce, restructure or cease its operations

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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.

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RESULTS OF OPERATIONS

FY 05 CURRENT THREE MONTHS VERSUS FY 04

Net sales for the quarter ended August 31, 2005 were \$1,943,450 versus \$2,016,298 for the same period of fiscal 2004, a decrease of \$72,848 or 4%. Revenues from the Singapore strategic manufacturing venture declined to \$153,660 in the three-month period ended August 31, 2005 from \$193,528 in the comparable period in 2004. Revenues from U.S. operations decreased to \$1,789,790 in the third quarter of 2005 from \$1,822,770 in 2004.

The decrease in sales for the U.S. operations are due to lower sales volumes in the 3rd quarter. AM continues to focus on a strategy of becoming a product based business and as these efforts continue AM will see increased sales revenues.

Cost of sales for the quarters ended August 31, 2005 and August 31, 2004 were \$1,550,991 and \$1,510,925, respectively. Cost of sales as a percentage of net sales was 80% for the third quarter of fiscal 2005, compared to 75% for the third quarter of fiscal 2004. The Company's gross profit percentage was 20 % in 2005 period, compared to 25% in the 2004 period. Raw material price increases lead to the cost of sales increased, then the gross profit percentage is getting lower accordingly.

Selling, general and administrative expenses for the third quarter of fiscal 2005 and 2004 were \$344,344 and \$401,192, respectively, a decrease of \$56,848 or 14%. There were abnormal legal and accounting expenses from 3rd quarter 2004 to the 2nd quarter of 2005. There were no unusual general and administrative expenses occurring in the 3rd quarter of fiscal 2005.

Interest expense for the third quarter of fiscal 2005 and 2004 was \$39,982 and \$34,451, respectively. Interest expense relates primarily to bank borrowings and is not expected to fluctuate significantly in the near future.

Net income for the third quarter of fiscal 2005 was \$20,357, compared to net income of \$35,561 for the third quarter of fiscal 2004. Basic and diluted income per share for the second quarter of fiscal 2005 was \$0.00 per share, compared to net income of \$0.00 per share for the third quarter of fiscal 2004.

FY 05 CURRENT NINE MONTHS VERSUS FY 04

Net sales for the nine-month period ended August 31, 2005 were \$5,967,379 versus \$5,856,963 for the same period of fiscal 2004, an increase of \$110,416 or 2%. Revenues from the Singapore strategic manufacturing venture declined to \$407,581 in the nine-month period ended August 31, 2005 from \$565,729 in the comparable period in 2004. Revenues from U.S. operations increased to \$5,559,798 in the nine-month period ended August 31, 2005 from \$5,291,234 in 2004.

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

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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 nine-month periods ended August 31, 2005 and August 31, 2004 were \$4,786,436 and \$4,661,987, respectively. The Company's gross profit percentage was 20% in the 2005 period, compared to 20% in the 2004 period.

Selling, general and administrative expenses for the nine-month periods ended August 31, 2005 and 2004 were \$1,259,710 and \$1,085,667, respectively, a decrease of \$174,043 or 16%. This decrease was due to operating efficiencies.

Interest expense for the nine-month periods ended August 31, 2005 and 2004 was \$113,471 and \$82,038, respectively. Interest expense relates primarily to bank borrowings and is not expected to fluctuate significantly in the near future.

Net loss for the nine-month period ended August 31, 2005 was \$241,860, compared to a net income of \$682,605 for the same period of fiscal 2004. Basic and diluted income (loss) per share for the nine-month period ended August 31, 2005 was \$(0.02) per share, compared to a net income of \$0.07 per share for the same period of fiscal 2004.

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

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LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were \$140,501 at August 31, 2005, compared with \$55,289 at November 30, 2004. Operating activities used \$137,747 during the nine-month period ended August 31, 2005, compared with \$146,148 in the corresponding period of fiscal 2004. The cash used by operating activities in the 2005 period resulted primarily from an increase in inventory, prepaid expenses and other, offset by an increase in accounts payable and accrued liabilities, and a decrease in accounts receivable of \$403,783 and \$92,220 and \$194,716, and \$122,099 respectively.

Capital expenditures were \$22,261 for the nine months ended August 31, 2005, compared to \$113,931 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 and sales of common stock to supplement internally generated cash flow. Activity related to short- and long-term borrowings and sales of common stock in the nine-months ended August 31, 2005 resulted in cash provided by financing activities of \$245,220.

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In August, 2005, ADMG issued to each of the Lenawee Trust and Plus Four Private Equities, L.P. 625,000 shares of ADMG's common stock for \$0.20 per share (\$125,000 each). The Lenawee Trust is an affiliate of Timothy R. Busch, the Chairman of ADMG's Board of Directors.

At August 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 August 31, 2005, the Company had limited cash reserves.

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 August 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 August lose market share and future revenue and earnings August 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 August 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:

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

General market conditions and domestic or international macroeconomic factors unrelated to the Company's performance August 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 August 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 August 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

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concluded that the disclosure controls and procedures were effective as of August 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 August 31, 2005 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

NONE

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

In August, 2005, ADMG issued to each of the Lenawee Trust and Plus Four Private Equities, L.P. 625,000 shares of ADMG's common stock for \$0.20 per share (\$125,000 each). The Lenawee Trust is an affiliate of Timothy R. Busch, the Chairman of ADMG's Board of Directors.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

At August 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.

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
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