

NITCHES INC
Form 10-K/A
July 17, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K/A
Amendment No. 2

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

For the fiscal year ended August 31, 2005

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

For the transition period from _____ to _____.

Commission File Number 0-13851

NITCHES, INC.

(Exact name of registrant as specified in its charter)

California
(State of Incorporation)

95-2848021
(I.R.S. Employer Identification No.)

10280 Camino Santa Fe
San Diego, California
(Address of principal executive offices)

92121
(Zip Code)

Registrant's telephone number: (858) 625-2633

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|----------------------------|---|
| Common Stock, no par value | NASDAQ Capital Market |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 an accelerated filer (as defined in rule 12b-2 of the Exchange Act).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

As of October 31, 2005, 1,171,169 shares of the Registrant's common stock were outstanding.

Edgar Filing: NITCHES INC - Form 10-K/A

The aggregate market value of all equity securities held by non-affiliates of the Registrant as of the last business day of the most recently completed second fiscal quarter (February 28, 2005) based on the closing price of the Registrant's stock in the NASDAQ Capital Market on that date was \$5,047,738.

EXPLANATORY NOTE

This amendment to the annual report of Nitches, Inc. on form 10-K for the fiscal year ended August 31, 2005 is being made to:

- 1) Revise the cover page to eliminate the note for documents incorporated by reference;
- 2) Revise the presentation of the Company's Consolidated Balance Sheets, Consolidate Statements of Cash Flows and Trade Receivables footnote to eliminate the netting of receivables due from factor with advances due to factor as required by Rule 5-02.19(2) of Regulation S-X;
- 3) Change the terminology for shipping and handling costs billed to customers as freight costs ;
- 4) Include a schedule under the Income Taxes footnote disclosing the amount and expiration of our net operating loss carry forward;
- 5) Present that information required under Part III which had been incorporated by reference to the Company's Definitive Proxy Statement, as the proxy was not timely filed to allow such incorporation by reference;
- 6) File as Exhibit 14.1 the Company's Code of Ethics and Business Conduct and provide the website address where the Company makes the most current version publicly available;
- 7) Revise the certifications required under Section 302 of Sarbanes Oxley and Item 601(b)(31) to reflect the exact language required by these regulations.

PART I

Item 1 - Business

Cautionary Statement Under the Private Securities Litigation Reform Act of 1995

Statements in the annual report on Form 10-K under the caption "Business", as well as oral statements that may be made by the Company or by officers, directors or employees of the Company acting on the Company's behalf, that are not historical fact constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements involve known and unknown risks and uncertainties that may cause the Company's actual results in future periods to differ materially from forecasted results. Those risks include a softening of retailer or consumer acceptance of the Company's products, pricing pressures, competitive forces, worldwide political instability, or unanticipated loss of a major customer. In addition, the Company's business, operations and financial condition are subject to reports and statements filed from time to time with the Securities and Exchange Commission.

General

Nitches, Inc. (the Company or Nitches) designs, markets and distributes wholesale apparel to national retailers, regional chain stores and specialty retailers. Product offerings include men's casual lifestyle clothing by Newport Blue®, men's golf apparel by The Skins Game®, women's sleepwear by Dockers®, women's western wear by Adobe Rose® and Southwest Canyon®, and women's private label apparel and Saguaro® outerwear. The Company provides fashionable clothing to the popularly priced market segment that generally retails between \$10 and \$35 per item. For 35 years the Company has competed on the basis of price, quality, the desirability of its fabrics and designs, and the reliability of its delivery and service.

In recent years the apparel market has been marked by deflation and reduced profit margins in many markets. The consolidation of retail stores among a small number of national chains has given these chains leverage to seek lower pricing and thereby reduce profit margins for suppliers such as Nitches. During this same time, more vertical retailers who design, produce and sell their own product direct to consumers have emerged. Management has responded by discontinuing product lines in areas where the Company cannot maintain a reasonable profit margin and to develop products in categories that are underserved or where the Company retains an advantage in sources of supply, design or distribution.

Recent Developments

Subsequent to fiscal 2005, on October 24, 2005, the Company acquired the remaining seventy-two percent (72%) of Designer Intimates, Inc. that Nitches did not own. Designer Intimates is a New York City based importer and distributor of both branded and private label women's sleepwear, robes, loungewear, swimwear and intimate apparel; men's sleepwear, robes, and loungewear; and infant's and children's sleepwear and robes. With the Designer Intimates acquisition, the Company has become a diversified supplier of women's intimate apparel at multiple levels of retail distribution, added significant revenues, further strengthened the Company's product mix, and added to the Company's portfolio of brands.

Product Development and Design

The in-house design and merchandising staff of Nitches develops high quality lines of clothing for each of the Company's brands. Using computer-based design and illustration technology, designers create original garment bodies (styles) with unique fabric prints and designs. The Company also may incorporate prints and concepts purchased from freelance artists and independent design services. The use of advanced design tools allows the Company to simulate a wide variety of product for development and presentation to retailers on printed storyboards and in catalogs. The time and expense of sample production is thereby avoided or reduced as merchandisers narrow and refine product lines.

Nitches responds to frequent style changes in women's and men's clothing by maintaining a program of evaluating current trends in style and fabric. In an effort to continually stay abreast of fashion trends, Company representatives shop at department and specialty stores in the United States, Europe, Japan and other countries that are known to sell merchandise with advanced styling direction. The Company may also seek input from selected customers and other industry resources. Design teams then select styles, fabrics, and colors that interpret current fashion trends for their respective product lines.

Retail store buyers may also provide specifications to the Company or may select for sale through their private label apparel programs styles from product lines Nitches designers have developed. The Company then manufactures and imports these goods which are generally sold under a label owned by or exclusive to a retailer. Retailers rely on the established reputation of the Company for arranging for foreign manufacture on a reliable, expeditious and cost-effective basis.

Sources of Supply

Over 95% of the garments sold by the Company are manufactured abroad. Contracting with foreign manufacturers enables the Company to take advantage of prevailing lower labor rates, with the consequent ability to produce a quality garment that can be retailed in the popular, value and moderate price ranges. The Company arranges for the production of garments with suppliers on a purchase order basis, with each order generally backed by an irrevocable letter of credit. The Company does not have any long-term contractual arrangements with manufacturers. This provides the Company with flexibility regarding the selection of manufacturers for future production of goods. The Company believes that it could replace the loss of any particular manufacturer in any country within a reasonable time period. However, in the event of the loss of a major manufacturer the Company could experience a temporary interruption in supply.

As a result of import restrictions on certain garments imposed by bilateral trade agreements between the United States and certain foreign countries, the Company has sought diversity in the number of countries in which it has manufacturing arrangements. The percentage of total purchases from particular countries varies from period to period based upon quota availability and price considerations. The Company has arranged, and will continue to arrange, for production in the United States when economically feasible to meet specific needs.

The following table shows the percentage of the Company's total purchases, not including freight charges, duties and commissions, from each country for the years ended August 31, 2005, 2004, and 2003.

Percent of Total Purchases by Country

| | Year ended August 31, | | |
|---|-----------------------|------|------|
| | 2005 | 2004 | 2003 |
| Cambodia | 36.4 | 27.6 | 34.4 |
| India | 16.7 | 18.8 | 12.8 |
| Pakistan | 16.4 | 16.5 | 2.7 |
| Hong Kong | 15.4 | 7.1 | 3.5 |
| Sri Lanka | 5.7 | 13.6 | 7.0 |
| United States | 4.9 | 14.5 | 7.7 |
| China | 2.7 | | |
| Mexico | 1.0 | | |
| Countries less than .95% each in the current year | 0.8 | 1.9 | 31.9 |

The Company owns 100% of the outstanding capital stock of Nitches Far East Ltd., a Hong Kong corporation that performs production coordination, quality control and sample production services for the Company. Furthermore, the Company works with independent agents specializing in sourcing and production control in Cambodia, India, Pakistan and Sri Lanka. The Company and its subsidiary perform no material manufacturing and maintain no significant assets outside the United States.

In some cases, the manufacturer or agent with whom the Company contracts for production may subcontract work. Most of the listed countries have numerous suppliers that have the technical capability to manufacture garments of the type sold by the Company. The availability of alternate sources tends to offset the risk associated with the loss of a major manufacturer.

The Company believes that the production capacity of foreign manufacturers with which it has developed, or is developing, a relationship is adequate to meet the Company's production requirements for the foreseeable future. However, because of existing and potential import restrictions, the Company continues to attempt to diversify its sources of supply.

When management believes, based on previous experience and market performance, that additional orders for certain garments will be received, the Company may place production runs in amounts in excess of firm customer orders. This may allow the Company to achieve overall lower costs as well as to be able to respond more quickly to customer delivery requirements. However, the Company bears the consequent risk if garments purchased in advance of receipt of customer purchase orders do not sell.

Raw Materials

A substantial majority of the clothing sold by the Company is made of 100% cotton, although the Company also utilizes cotton blends, polyester, rayon and leather fabrics. All of these fabrics are readily available in most countries in which the Company contracts for production and are easily imported to those countries that do not have an internal supply of such fabric. The majority of the fabric that the Company uses comes from multiple sources of supply in China. The Company is not dependent on a single source of supply for fabric that is not readily replaceable.

Quality Control

Company representatives regularly visit manufacturers to inspect garments and monitor production facilities in order to assure timely delivery, maintain quality control and issue inspection certificates. Furthermore, through these representatives and independent inspectors from major retailers, the Company ensures that the factories the Company uses for production adhere to policies consistent with prevailing labor laws. A sample of garments from a percentage of each production run is inspected before each shipment. Letters of credit arranged by the Company require, as a condition to the release of funds to the supplier, that a representative of the Company sign an inspection certificate.

Marketing and Distribution

The Company sells its products through an established sales network consisting of both in-house sales personnel and independent sales representatives. The Company does not generally advertise, although customers sometimes feature the Company's products in their advertisements. Employees in Company showrooms in New York City and Los Angeles represent the Company in soliciting orders nationally. In addition, senior managers of the Company have primary responsibility for sales to certain key accounts. The Company's products are also marketed by approximately 51 independent commissioned sales representatives.

The presence of a national brand has emerged as a principle factor in apparel buying decisions. In response, the Company has sought ownership or control of recognized brands for the categories of apparel which it distributes. In an agreement with Designer Intimates, the Company markets Dockers® ladies sleepwear in a variety of fabrics and styles, including pajamas, nightshirts and nightgowns. The Company designs and distributes men's wear under the Newport Blue® and The Skins Game® labels through agreements with third parties. The Company distributes women's Western wear shirts under its own labels Adobe Rose® and Southwest Canyon®. Western jeans are sold under the label Posted® through a licensing agreement with a third party supplier. During 2005, we also began importing and distributing women's sweaters and Saguaro® leather outerwear under an agreement with a third party.

Most garments are shipped by suppliers in bulk form to the Company's warehouse in San Diego, where they are sorted, stored and packed for distribution to customers. From time to time, the Company may rent additional short-term warehouse space as needed to accommodate its requirements during peak shipping periods. In addition, to facilitate shipping to customers, some of its overseas suppliers perform sorting, price ticketing, hanging, and packing functions.

Purchase orders may be canceled by the Company's customers in the event of late delivery or in the event of receipt of nonconforming goods. Late deliveries usually are attributable to production or shipping delays beyond the Company's control. In the event of canceled purchase orders, rejections or returns, the Company will sell garments to other retailers, off-price discount stores or garment jobbers. In the past the Company has often been able to recover from its manufacturers some portion of its expenses or losses associated with sales below cost for causes attributable to manufacturing problems. However, the Company has also historically experienced losses on merchandise that is rejected or returned. Yet past losses on rejected and returned merchandise have not been material to the Company.

The Company's business is concentrated on certain significant customers. Sales to one customer accounted for 53.1% of the Company's net sales during fiscal 2005. Two customers accounted for 32.3% and 31.3% respectively, of the Company's net sales in fiscal 2004. While the Company believes its relationships with its major customers are good, because of competitive changes and availability of the types of garments sold by the Company from a number of other suppliers, there is the possibility that any customer could alter the amount of business it does with the Company. If the Company experiences a significant decrease in sales to any of its major customers, and is unable to replace such sales volume with sales to other major customers, there could be a material adverse financial effect on the Company.

Imports and Import Restrictions

The ability of the Company to import garments is subject to the risks of international commerce. Imports into the United States are affected by, among other things, the cost of transportation and import restrictions that limit the specific number of garments that may be imported from any country during a specific period. Countries from which the Company purchases garments may impose or alter quotas, duties or other restrictions on substantially all of the products imported by the Company. Because of this uncertainty, the Company has sought diversity in the number of countries in which it has garments manufactured.

Import restrictions have, in some cases, increased the cost of finished goods to the Company as a result of increased competition for a restricted supply of goods. The Company's future results may also be affected by additional bilateral or unilateral trade restrictions, a significant change in existing quotas, political instability resulting in the disruption of trade from exporting countries, or the imposition of additional duties, taxes and other charges on imports.

Because of import restrictions and quotas, embargos, and political instability in some countries of origin, the Company may be unable, from time to time, to import certain types of garments. Because of the Company's dependence on foreign suppliers, a significant tightening or utilization of import quotas for the types of garments imported by the Company, applicable to a substantial number of countries from which the Company imports, could force the Company to seek other sources of supply and to take other actions which could increase costs of production. This could also cause delays in production and result in cancellation of orders. Any of these factors could result in an adverse financial impact on the Company.

The Company believes it has the ability to locate, establish relationships with and develop manufacturing sources in countries where the Company has not previously operated. The time required to commence contract production in supplier countries ranges from several weeks in the case of a country with a relatively well developed garment manufacturing industry to four months or more for a country in which there are less developed capabilities. The cost to the Company of arranging for production in a country generally involves management time and associated travel expenses.

Backlog

At August 31, 2005 and August 31, 2004 the Company had unfilled customer orders of \$9.9 million and \$10.5 million, respectively, with such orders generally scheduled for delivery by March 2006 and 2005, respectively. The decrease in order backlog was primarily in the Company's sleepwear product line due to delays in anticipated order placement from Kohl's as they looked to place orders closer to requested delivery dates in order to more accurately anticipate consumer demand. This decline was partially offset by the addition of orders for private label apparel and Saguaro® outerwear. The amount of unfilled orders at any given time is affected by a number of factors, including the timing of the receipt and processing of customer orders and the scheduling of the manufacture and shipping of the product, which may be dependent on customer requirements.

As of November 30, 2005, the Company had on-hand unfilled customer orders of \$12.3 million as compared to \$12.9 million at November 30, 2004, with such orders generally scheduled for delivery by May 2006 and 2005, respectively. The decrease in backlog is due to reduced sleepwear orders, offset partially by the inclusion of orders for private label apparel through the Company's agreement with a third party.

Backlog amounts include both confirmed orders and unconfirmed orders that the Company believes, based on industry practice and past experience, will be confirmed. While cancellations, rejections and returns have generally not been material in the past, there can be no assurance that such action by customers will not reduce the amount of sales realized from the backlog of orders at either August 31, 2005 or November 30, 2005.

Competition

The apparel industry is highly competitive and consists of many manufacturers and distributors, none of which accounts for a significant percentage of total sales, but many of which are larger and have substantially greater resources than the Company. The Company competes with a number of companies which import clothing from abroad for wholesale distribution, with domestic retailers having established foreign manufacturing capabilities and with domestically produced goods. Management believes that the Company competes upon the basis of price, quality, the desirability of its fabrics and styles, and the reliability of its service and delivery. In addition, the Company has developed long-term working relationships with manufacturers and agents, which presently provide the Company with reliable sources of supply. Increasingly the Company competes directly with agents or with retailers' own sourcing affiliates who own factories or have established production relationships that allow these companies to directly supply retailers with the desired product at a lower cost.

Employees

The Company's ability to compete effectively is dependent, in part, on its ability to retain managerial personnel with experience in locating, developing and maintaining reliable sources of supply and to retain experienced sales and product development personnel. As of August 31, 2005, the Company had 43 full-time employees, of whom nine worked in executive, administrative or clerical capacities and 26 worked in sales, design, and production. Additionally, the Company employs eight individuals in its Hong Kong office who are responsible for fabric and trim sourcing, product development and quality control. The Company contracts with an unrelated entity to provide warehouse services. The Company may also employ temporary personnel on a seasonal basis. None of the Company's employees is represented by a union. The Company considers its working relationships with its employees to be good and has never experienced an interruption of its operations due to any kind of labor dispute.

Investments

On October 1, 2002, the Company acquired a 28% interest in Designer Intimates, Inc., which owns 100% of NAP, Inc. (NAP), a New York-based intimate apparel company. NAP is a leading designer, marketer and distributor of women's sleepwear, robes, loungewear, daywear and foundations in the United States. Designer Intimates acquired NAP from its founders and obtained a credit line of approximately \$12 million from HSBC which was later assumed by CIT that is secured by the inventory and accounts receivable of NAP and the guarantees of shareholders of Designer Intimates. The Company has guaranteed \$3.0 million of this credit line and this guaranty formed the consideration from the company for its 28% ownership interest in Designer Intimates. In the event of a call on this guaranty by CIT, Nitches has a contract with the remaining shareholders of Designer Intimates to limit Nitches' exposure to 28% of the called value, subject to the maximum guaranty of \$3.0 million. The major shareholder in Designer Intimates is Haresh T. Tharani, Chairman of Bill Blass, Ltd. The Company and Mr. Tharani have a relationship that began in 1995 when the company sold its junior sportswear business to a company also owned by Mr. Tharani, Design & Source Holding Company. Steven Wyandt serves on the boards of directors of NAP and Designer Intimates.

Subsequent to fiscal 2005, on October 24, 2005, the Company acquired the remaining seventy-two percent (72%) of the issued and outstanding stock of Designer Intimates, Inc. This transaction is further described in the Subsequent Event footnote 13 on page 29. There are additional disclosures regarding the investment in the Equity Investment discussion on page 10 and page 25 presents condensed financial statements for Designer Intimates.

Item 1A Risk Factors

Certain Business Risk Factors

We rely on a few key customers, and the loss of any one key customer would substantially reduce our revenues.

We derive a significant amount of our revenues from a few major customers. A significant decrease in business from or loss of any of our major customers could harm our financial condition by causing a significant decline in revenues attributable to such customers.

The Company's business is concentrated on certain significant customers. Sales to one customer accounted for 53.1% of the Company's net sales during fiscal 2005. Two customers accounted for 32.3%, and 31.3% respectively, of the Company's net sales in fiscal 2004. While the Company believes its relationships with its major customers are

good, we do not have long-term contracts with any of them and purchases generally occur on an order-by-order basis. Because of competitive changes and the availability of the types of garments sold by the Company from a number of other suppliers, there is the possibility that any customer could alter the amount of business it does with the Company. If the Company experiences a significant decrease in sales to any of its major customers, and is unable to replace such sales volume with orders from other major customers, there could be a material adverse financial effect on the Company.

Our business depends on consumer spending patterns.

Our business is sensitive to a number of factors that influence the levels of consumer spending, including political and economic conditions such as recessionary environments, the levels of disposable consumer income, consumer debt, interest rates and consumer confidence. Reduced consumer spending on apparel and accessories could have an adverse effect on our operating results.

We operate in a highly competitive and fragmented industry and our failure to successfully compete could result in a loss of one or more significant customers.

The retail apparel industry is highly competitive and fragmented. Our competitors include numerous apparel designers, manufacturers, importers and licensors, many of which have greater financial and marketing resources than us. We believe that the principal competitive factors in the apparel industry are:

timeliness, reliability and quality of services provided,
pricing that supports retailers' targeted gross margins,
brand name and brand identity, and
the ability to anticipate customer requirements and consumer demand.

If we do not continue to provide high quality and reliable services on a timely basis at competitive prices, we may not be able to continue to compete in our industry. If we are unable to compete successfully, we could lose one or more of our significant customers which, if not replaced, could negatively impact our sales and financial performance.

We must successfully gauge fashion trends and changing consumer preferences to succeed.

Our failure to anticipate, identify and respond effectively to changing consumer demands and fashion trends could adversely affect acceptance of our products by retailers and consumers and may result in a significant decrease in net sales or leave us with a substantial amount of unsold inventory. We believe that our success depends on our ability to anticipate, identify and respond to changing fashion trends in a timely manner. Our products must appeal to a broad range of consumers whose preferences cannot be predicted with certainty and are subject to rapid change. If our products are not successfully received by retailers and consumers and we are left with a substantial amount of unsold inventory, we may be forced to rely on markdowns or promotional sales to dispose of excess, slow-moving inventory. If this occurs, our business, financial condition, results of operations and prospects may be harmed.

We depend on our key personnel.

Our success depends to a large extent upon the continued services of our officers and managers. The loss of the services of any key member of management could have a material adverse effect on our ability to manage our business. Our continued success is dependent upon our ability to attract and retain qualified management, administrative and sales personnel to support our future growth. Our inability to do so may have a significant negative impact on our ability to manage our business.

Item 1B Unresolved Staff Comments

None.

Item 2 - Properties

The Company currently leases properties in New York, California and Hong Kong. The Company leases one showroom in New York, one in Los Angeles and approximately 30,000 square feet of warehouse with administrative offices in San Diego. The Company may lease additional short-term warehouse space from time to time as needed.

Item 3 - Legal Proceedings

By letter dated December 6, 2004, the Company, together with Steve Wyandt and Paul Wyandt, were served notice by the U.S. Department of Labor that a complaint had been filed with the office of Occupational Safety & Health Administration (OSHA) by Angel Martin Aquino alleging discriminatory employment practices in violation of Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002 (also known as the Sarbanes-Oxley Act). OSHA thoroughly investigated the matter, found no basis for the complaint, and dismissed the matter on February 25, 2005.

Item 4 - Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders during the fourth quarter of fiscal 2005.

PART II**Item 5 - Market for the Registrant's Common Stock and Related Shareholder Matters**

The Company's Common Stock trades on The NASDAQ Capital Market under the symbol NICH. The number of shareholders of record of the Common Stock on October 31, 2005 was 103. The Company believes that there are a significant number of beneficial owners of its Common Stock whose shares are held in street name. The closing sales price of the Common Stock on October 31, 2005 was \$5.10 per share.

The high and low closing sale prices, adjusted for stock dividends, for each fiscal quarter ending on the specified date during the last two fiscal years were as follows:

| | <u>High</u> | <u>Low</u> |
|--|-------------|------------|
| FISCAL YEAR ENDED AUGUST 31, 2005 | | |
| First Quarter | \$ 7.16 | \$ 5.28 |
| Second Quarter | 6.65 | 4.21 |
| Third Quarter | 5.22 | 3.60 |
| Fourth Quarter | 5.28 | 4.35 |
| FISCAL YEAR ENDED AUGUST 31, 2004 | | |
| First Quarter | \$ 5.16 | \$ 3.87 |
| Second Quarter | 6.25 | 3.63 |
| Third Quarter | 8.69 | 5.10 |
| Fourth Quarter | 8.98 | 4.83 |

The Company does not have a quarterly dividend policy and did not pay or declare any dividends during fiscal year 2005 and 2004.

Item 6 - Selected Financial Data (In thousands, except per share amounts)**OPERATING RESULTS DATA:**

| | Fiscal Year Ended August 31, | | | | |
|--|--|-----------|-----------|-----------|-----------|
| | 2005 | 2004 | 2003 | 2002 | 2001 |
| | (In thousands, except per share amounts) | | | | |
| Net sales | \$ 26,320 | \$ 32,179 | \$ 28,440 | \$ 29,589 | \$ 33,780 |
| Cost of goods sold | 20,534 | 22,783 | 21,856 | 22,214 | 24,854 |
| Gross profit | 5,786 | 9,396 | 6,584 | 7,375 | 8,926 |
| Selling, general and administrative | 8,175 | 8,389 | 7,663 | 7,132 | 7,313 |
| Income (loss) from operations | (2,389) | 1,007 | (1,079) | 243 | 1,613 |
| Other income | 460 | | 3 | 16 | 247 |
| Interest expense | (102) | (93) | (83) | (80) | (162) |
| Net income (loss) from equity investment | (64) | 14 | (236) | | |
| Income (loss) before income taxes | (2,095) | 928 | (1,395) | 179 | 1,698 |
| Provision for (benefit from) income taxes | (894) | 371 | (425) | 63 | 615 |
| Net income (loss) | \$ (1,201) | \$ 557 | \$ (970) | \$ 116 | \$ 1,083 |
| Basic earnings per share | \$ (1.03) | \$.48 | \$ (0.83) | \$ 0.10 | \$ 0.92 |
| Diluted earnings per share | \$ (1.03) | \$.48 | \$ (0.83) | \$ 0.10 | \$ 0.92 |
| Cash dividends per common share | \$ | \$ | \$ 0.30 | \$ 0.45 | \$ 1.35 |
| Weighted average number of common shares (000 s): | | | | | |
| Basic | 1,171 | 1,171 | 1,171 | 1,112 | 1,172 |
| Diluted | 1,171 | 1,171 | 1,171 | 1,112 | 1,172 |

CONSOLIDATED BALANCE SHEETS DATA:

| | As of August 31 | | | | |
|---|-----------------|----------|----------|----------|----------|
| | 2005 | 2004 | 2003 | 2002 | 2001 |
| | (In thousands) | | | | |
| Cash | \$ 192 | \$ 219 | \$ 110 | \$ 182 | \$ 192 |
| Receivables | 1,102 | 3,587 | 922 | 4,523 | 3,179 |
| Income taxes receivables | 212 | | 466 | 118 | 75 |
| Inventories | 4,582 | 3,373 | 4,974 | 5,306 | 5,408 |
| Total current assets | 7,257 | 7,556 | 6,721 | 10,378 | 9,157 |
| Total assets | 7,322 | 7,622 | 6,847 | 10,503 | 9,289 |
| Accounts payable and accrued expenses | 2,916 | 1,885 | 1,707 | 4,277 | 2,684 |
| Total current liabilities | 2,916 | 1,939 | 1,707 | 4,277 | 2,684 |
| Shareholders' equity | \$ 4,260 | \$ 5,461 | \$ 4,904 | \$ 6,226 | \$ 6,605 |
| Other Financial Information: | | | | | |
| Gross margin | 22.0% | 29.2% | 23.2% | 24.9% | 26.4% |
| Operating margin (deficit) | (9.1)% | 3.1% | (3.8)% | 0.8% | 4.8% |
| Net income (loss) as a percent of sales | (4.6)% | 1.7% | (3.4)% | 0.4% | 3.2% |
| Liquidity: | | | | | |
| Current ratio | 2.49 | 3.90 | 3.94 | 2.43 | 3.41 |
| Working capital | \$ 4,341 | \$ 5,617 | \$ 5,014 | \$ 6,101 | \$ 6,473 |

Item 7 -

Nitches, Inc and Subsidiaries
Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement Under the Private Securities Litigation Reform Act of 1995

Statements in the annual report on Form 10-K under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations", as well as oral statements that may be made by the Company or by officers, directors or employees of the Company acting on the Company's behalf, that are not historical fact constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements involve known and unknown risks and uncertainties that may cause the Company's actual results in future periods to differ materially from forecasted results. Those risks include, among others, a softening of retailer or consumer acceptance of the Company's products, pricing pressures and other competitive forces, or unanticipated loss of a major customer. In addition, the Company's business, operations and financial condition are subject to reports and statements filed from time to time with the Securities and Exchange Commission.

Critical Accounting Policies

Several of the Company's accounting policies involve significant judgments and uncertainties. The policies with the greatest potential effect on the Company's results of operations and financial position include the estimated collectibility of accounts receivable and the recovery value of obsolete or overstocked inventory.

Revenue Recognition. The Company recognizes revenue at the time products are shipped based on its terms of F.O.B. shipping point, where risk of loss and title transfers to the buyer at time of shipment. The Company records sales in accordance with SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*. Under these guidelines, revenue is recognized when all of the following exist: persuasive evidence of a sale arrangement exists, delivery of the product has occurred, the price is fixed or determinable and payment is reasonably assured. Provisions are made currently for estimated product returns and sales allowances.

Allowances for Sales Returns, Doubtful Accounts and Other. Sales are recorded net of estimated future returns, uncollectible accounts receivable and other customer related allowances. Management analyzes historical returns and bad debt expense, current economic trends, changes in customer demand and sell-through of our products when evaluating the adequacy of these allowances. In addition, the Company may provide warehousing credits and other allowances to certain customers in accordance with industry practice. These reserves are determined based on historical experience, budgeted customer allowances and existing commitments to customers. Although management believes it has established adequate reserves with respect to these items, actual activity could vary from management's estimates and such variances could have a material impact on reported results.

Deferred Taxes. Deferred taxes are determined, based on the differences between the financial statement and tax bases of assets and liabilities, as well as the future benefit of any net operating loss carryforward, using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. In assessing the need for a valuation allowance management considers estimates of future taxable income and ongoing prudent and feasible tax planning strategies.

Results of Operations

Years Ended August 31, 2005 and 2004

Net sales for the fiscal year ended August 31, 2005 decreased approximately \$5.9 million or 18.2% compared to the fiscal year ended August 31, 2004. This decrease was attributable to lower unit sales of the Company's men's wear and women's sleepwear products. The men's wear decline was driven primarily by the loss of Sam's Club as a customer, offset partially by an increase in orders from Kohl's and Stein Mart, while the sleepwear decline came as a result of reduced orders from Mervyn's and the loss of Sears as a customer.

Edgar Filing: NITCHES INC - Form 10-K/A

Cost of sales as a percent of net sales increased by 7.2% leading to a decrease in gross profit margin from 29.2% to 22.0% between fiscal 2004 and 2005. The decrease in gross margin came primarily as the result of the loss of higher gross margin sales (in excess of 40%) in the Company's men's wear line, which were included in the year earlier period. The Company's product mix constantly changes to reflect customer mix, fashion trends and changing seasons. Consequently, gross margin is likely to vary on a quarter-to-quarter basis and in comparison to gross margins generated in the same period of prior fiscal years.

Selling, general and administrative expenses decreased in dollar amount from \$8.4 million in fiscal 2004 to \$8.2 million in fiscal 2005, primarily due to a decrease in sales commissions and selling related expenses in line with the reduced sales volume in the Company's men's wear product line. On a percent of net sales basis, selling, general and administrative expenses increased from 26.1% in fiscal 2004 to 31.1% in fiscal 2005, due to the decrease in sales as it relates to the fixed portion of the expenses.

Other income for the fiscal year 2005 of \$460,000 includes \$453,000 for the repayment of a note receivable that the Company issued related to a sale of product lines in 1995. This note had been written off by the Company in fiscal 2001 as part of a credit reorganization of the buyer. However, due to improved financial performance of the buyer achieved in part through continued guidance and support from the Company, the buyer recently elected to repay the balance of the note.

Interest expense increased \$9,000 for the current year to \$102,000 as compared to \$93,000 for the year ended August 31, 2004. This 9.7% increase was primarily due to the continued rising interest rates charged by the Company's factor, despite the reduction in advance requirements under the Company's factoring agreement in line with reduced sales and purchasing activity.

The Company's income tax provision for the year ended August 31, 2005, reflects an \$894,000 tax benefit on the Company's pretax loss of \$2,032,000 before the recognized operating loss of \$64,000 from the unconsolidated subsidiary. The Company's income tax provision for the year ended August 31, 2004, reflects a \$371,000 tax expense on pretax income of \$914,000 before the recognized operating income of \$14,000 from the unconsolidated subsidiary. The decrease in taxes is a result of lower pre-tax earnings as compared to the prior year.

Years Ended August 31, 2004 and 2003

Net sales for the fiscal year ended August 31, 2004 increased approximately \$3.7 or 13.1% compared to the fiscal year ended August 31, 2003 due to an increase in unit sales in the Company's men's wear line resulting from the addition of a few large customers. Cost of sales as a percent of net sales decreased by 6% leading to an increase in gross profit margin from 23.2% to 29.2% between fiscal 2003 and 2004. The gross margin increase came as a result of the increased sales volume in the Company's men's wear line, which has historically generated higher gross margins than the Company's average realized gross margin.

The Company's product mix constantly changes to reflect customer mix, fashion trends and changing seasons. Consequently, gross margins are likely to vary on a quarter-to-quarter basis and in comparison to gross margins generated in prior fiscal years.

Selling, general and administrative expenses increased in dollar amount from \$7.7 million in fiscal 2003 to \$8.4 million in fiscal 2004, primarily due to increased sales commission expenses as a result of the Company's sales mix shifting from non-commissioned sleepwear sales to commissioned men's wear sales. On a percent of net sales basis, selling, general and administrative expenses declined from 26.9% in fiscal 2003 to 26.1% in fiscal 2004, due primarily to the increase in sales volume in the Company's men's wear line. Management continually monitors expense levels and strives to maintain streamlined operations while making investments intended to generate optimal sales performance.

Interest expense increased \$10,000 for the current year to \$93,000 as compared to \$83,000 for the year ended August 31, 2003. This 12% increase was due to more advances made under the Company's factoring agreement in line with larger inventory purchases from January through April, during which time the majority of the Company's increase in annual sales volume was concentrated.

Edgar Filing: NITCHES INC - Form 10-K/A

The Company's income tax provision for the year ended August 31, 2004, reflects a \$371,000 tax expense on pretax income of \$914,000 before the recognized operating income of \$14,000 from the unconsolidated subsidiary. The Company recognized a \$425,000 tax benefit on the Company's pretax loss for the year of \$1,159,000 prior to the recognition of \$236,000 operating loss from the unconsolidated subsidiary. The increase in taxes is a result of higher pre-tax earnings as compared to the prior year.

Equity Investment

In October 2002, the Company acquired a 28% interest in Designer Intimates, Inc., which owns 100% of NAP, Inc., a New York-based intimate apparel company. Designer Intimates had acquired NAP from its founders and obtained a credit line of approximately \$12 million from HSBC which was later assumed by CIT, secured by the inventory and accounts receivable of NAP and the guarantees of shareholders of Designer Intimates. Nitches guaranteed \$3 million of this credit line and this guaranty formed the consideration from Nitches for its 28% ownership interest in Designer Intimates. In the event of a call on this guaranty by CIT, Nitches has a contract with the remaining shareholders of Designer Intimates to limit Nitches' exposure to 28% of the called value, subject to the maximum guaranty of \$3.0 million. Nitches is currently liable for \$146,000, or 28%, of the accumulated shareholders' deficit of Designer Intimates of \$518,000.

Nitches reports any income or loss from the ongoing operation of Designer Intimates using the equity method of accounting, whereby Nitches' 28% interest in Designer Intimates is reported as a single line item on the Consolidated Statement of Operations. For fiscal year ended August 31, 2005, the Company recognized a loss of \$64,000 from the unconsolidated subsidiary. This loss is reported net of tax and does not provide a tax benefit to the Company. For that same period in fiscal 2005, Designer Intimates incurred a net loss of \$228,000 on sales of \$45.7 million.

Nitches has introduced Designer Intimates to the factories that Nitches uses for its own sleepwear product line. This provides access to a lower cost production base than Designer Intimates has had in Turkey where it has historically produced over ninety percent of its products which are predominantly robes and lounge wear. In an agreement with Designer Intimates, Nitches has produced a line of sleepwear under the Dockers label. This product contributed approximately \$9.0 and \$1.4 million dollars of sales for Nitches in fiscal years 2005 and 2004, respectively. As of August 31, 2005 and 2004, Nitches had a backlog of approximately \$4.1 and \$1.8 million for this product line, respectively.

Subsequent to fiscal 2005, on October 24, 2005, the Company acquired the remaining seventy-two percent (72%) of the issued and outstanding stock of Designer Intimates, Inc. This transaction is further described in the Subsequent Event footnote 13 on page 28.

Liquidity and Capital Resources

For the fiscal years ended August 31, 2005, 2004 and 2003, cash used by operating activities was approximately \$1.1 million, \$281,000 and \$1.2 million respectively. For the fiscal year ended August 31, 2005, in addition to the net loss, the increase in cash used by operating activities was due primarily to an increase in inventory in response to increased orders for fall 2005 as compared to fall 2004, and a decrease in amounts due from factor due to reduced shipping in July and August 2005 as compared to the prior year. For the fiscal year ended August 31, 2004, cash provided by net income was offset by an increase in amounts due from factor due to increased sales in July and August 2004 as compared to 2003, offset partially by a decrease in taxes payable in inventories in line with reduced orders for fall 2004 as compared to fall 2003. For the fiscal year ended August 31, 2003, cash used by operating activities was due primarily to a net loss for the fiscal year coupled with a decrease in accounts payable due to the timing of certain payments to our manufacturers, offset partially by reduced assignments to the factor.

For the fiscal year ended August 31, 2005, net cash used by investing activities of \$168,000 was primarily for a contribution of capital to Designer Intimates. Minimal cash was used in each of the three years for the purchase of furniture and equipment used in the ordinary course of business operations.

For the fiscal years ended August 31, 2005, 2004 and 2003, cash provided by financing activities was approximately \$1.2 million, \$397,000 and \$1.2 million respectively. For each of the fiscal years, cash provided by financing activities was attributable to advances from the Company's factor in accordance with the terms of the factoring agreement. For 2003, cash provided by such advances were partially offset by dividends paid to shareholders.

Edgar Filing: NITCHES INC - Form 10-K/A

Working capital decreased to \$4.3 million at August 31, 2005 as compared to \$5.6 million at August 31, 2004. The current ratio declined from 2.4:1 at August 31, 2004 to 1.7:1 at August 31, 2005. Current assets increased due to higher inventory levels and an increase in current deferred taxes related to the loss reported for fiscal 2005, offset partially by a decrease in amounts due from factor due to lower sales preceding the 2005 fiscal year end. Current liabilities increased due to a higher level of advances from the factor and an increase in accounts payable, which are both related to the operating loss incurred and the increase in inventories at year end.

The Company sells substantially all of its trade receivables to a factor (CIT) on a pre-approved, non-recourse basis. The Company attempts to make any recourse shipments on a COD basis or ensure that the customers' payments are backed by a commercial or standby letter of credit issued by the customers' bank. The amount of the Company's receivables which were recourse and were not made on a COD basis or supported by commercial or standby letters of credit at August 31, 2005 was approximately \$667,000 of which approximately \$388,000 had been collected through September 30, 2005.

Payment for non-recourse factored receivables is made at the time customers make payment to CIT or, if a customer is financially unable to make payment, within approximately 180 days of the invoice due date. Under the factoring agreement, the Company can request advances in anticipation of customer collections at CIT's prime rate (currently 6.75%) less one and one-half percent (1.5%). The amount of advances available to the Company is limited to eighty-five percent (85%) of non-recourse factored receivables.

The factoring agreement does not contain any financial covenants to which the Company must adhere. Advances are collateralized by all of the assets of the Company as well as a personal guaranty of the Company's Chairman Steven Wyandt. This guaranty allows CIT to recover up to \$1 million from Mr. Wyandt to offset any losses incurred in the event of liquidation.

The Company may also issue letters of credit through CIT for the purchase of inventory in the normal course of its operations. Letters of credit are subject to a limit of \$6.0 million. At August 31, 2005, the Company had outstanding letters of credit of approximately \$3.5 million for the purchase of finished goods, which had been opened through CIT.

The factoring agreement can be terminated by CIT on 30-days written notice. The Company believes the factoring agreement with CIT, along with expected cash flow from operating activities and current levels of working capital are adequate to fulfill the Company's liquidity needs for the foreseeable future.

The Company did not declare or pay any cash dividends in fiscal years 2004 or 2005. The Company does not have a stated dividend policy. On a quarterly basis the board evaluates the ability to pay dividends based upon profitability and financing needs.

Contractual Obligations and Commercial Commitments

The following table illustrates the Company's contractual obligations and commercial commitments as of August 31, 2005:

| | Payments due/Commitments expiring per period | | | | |
|--|--|---------------------|------------------|---------------------|-----------------|
| | Total Amounts Committed | Less than 1 year | 1-3 years | 4-5 years | Over 5 years |
| Operating leases | \$ 359,000 | \$ 345,000 | \$ 14,000 | | |
| Letters of credit | 3,520,000 | 3,520,000 | | | |
| Guarantees | 3,000,000 | | | 3,000,000* | |
| Total obligations & commitments | \$ 6,879,000 | \$ 3,865,000 | \$ 14,000 | \$ 3,000,000 | \$ |

* Due on demand

Inventory

In its ordinary course of operations, the Company generally makes some sales below its normal selling prices or below cost. Based on experience, management believes this will be true for some inventory held on or acquired after August 31, 2005. The amount of such sales depends on several factors, including general economic conditions, market conditions within the apparel industry, the desirability of the styles held in inventory and competitive pressures from other garment suppliers.

The Company's inventory increased from \$3.4 million at August 31, 2004 to \$4.6 million at August 31, 2005. The Company has established an inventory markdown reserve as of August 31, 2005, which management believes will be sufficient for current inventory that is expected to be sold below cost in the future. There can be no assurance that the Company will realize its expected selling prices or that the inventory markdown reserve will be adequate for items in inventory as of August 31, 2005 for which customer sales orders have not yet been received. The inventory markdown reserve is calculated based on specific identification of aged goods and styles that are slow-moving or selling off-price.

Impact of Exchange Rates

While the Company purchased over 95% of its products from foreign manufacturers in fiscal 2005, all of its purchases are denominated in United States dollars. Because the Company's products are sold primarily in the United States in dollar denominated transactions, the Company does not engage in currency hedging to reduce currency risk. A prolonged increase in the value of the dollar versus foreign currencies could enhance the Company's purchasing power for new purchase orders and reduce its cost of goods sold. Conversely, a prolonged decrease in the value of the dollar relative to foreign currencies could result in an increase in the Company's cost of manufacturing for new purchase orders and costs of goods sold.

Impact of Inflation and Deflation

Management does not believe that inflation has had any material impact upon the Company's revenues or income from operations to date. Management believes that the apparel sector in which the Company operates continues to experience deflation, contrary to the modest inflation experienced in the economy in general. The persistence of the consumer to buy on sale merchandise has put pressure on retail gross margins, which in turn has led to downward pressure from retailers on wholesale gross margins, in the form of lower negotiated purchase prices as well as selling cost adjustments taken as deductions against invoices issued by the Company. In the apparel industry, these selling cost adjustments are commonly referred to as markdown allowances or chargebacks. Without a corresponding decrease in fabric and labor prices, these markdown allowances have led to a decline in wholesale gross margins. The Company incurred \$652,000 in markdown allowances in fiscal 2005, as compared to \$750,000 incurred in fiscal 2004. Management believes these deflationary pressures will continue into the foreseeable future.

Use of Estimates

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

Recently Issued Accounting Pronouncements

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections (SFAS 154) which replaces APB Opinion No. 20 Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements-An Amendment of APB Opinion No. 28. SFAS 154 requires retrospective application to prior periods financial statement of a voluntary change in accounting principal unless it is not practical. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005, and is required to be adopted by the Company in the first quarter of fiscal 2007. Although the Company will continually evaluate its accounting policies, management does not currently believe adoption will have a material impact on the Company's results of operations, cash flows or financial position.

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 153, Exchanges of Nonmonetary Assets . (SFAS No. 153) which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 will be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not believe the adoption on will have a material impact on the Company s results of operations, cash flows or financial position.

Item 7A - Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the potential impact to our financial position, results of operations or cash flows due to adverse changes in the financial markets. We are exposed to market risk from changes in the base interest rate of our variable rate debt. A 1% change in interest rates would increase or decrease our annual interest expense by approximately \$27,000.

Item 8 - Financial Statements and Supplementary Data

Nitches, Inc. and Subsidiaries

***Index to Consolidated Financial Statements Filed with
the Annual Report of the Company on Form 10-K***

| | Page |
|---|-------------|
| <u>Reports of Independent Registered Public Accounting Firms</u> | 17 |
| <u>Consolidated Balance Sheets at August 31, 2005 and 2004</u> | 19 |
| <u>Consolidated Statements of Operations for the years ended August 31, 2005, 2004 and 2003</u> | 20 |
| <u>Consolidated Statements of Shareholders' Equity for the years ended August 31, 2005, 2004 and 2003</u> | 21 |
| <u>Consolidated Statements of Cash Flows for the years ended August 31, 2005, 2004 and 2003</u> | 22 |
| <u>Notes to consolidated financial statements</u> | 23 |

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Nitches, Inc. and Subsidiaries
San Diego, California

We have audited the accompanying consolidated balance sheets of Nitches, Inc. and subsidiaries as of August 31, 2005 and the related consolidated statements of operations, shareholders' equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Nitches, Inc. and subsidiaries as of August 31, 2005 and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Berenson LLP

New York, New York
October 14, 2005, except note 13, as to which the date is October 24, 2005.
(May 6, 2006 as to the restatement described in note 14)

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Nitches, Inc.
San Diego, California

We have audited the accompanying consolidated balance sheets of Nitches, Inc. and subsidiaries as of August 31, 2004 and the related consolidated statements of income, shareholders' equity and cash flows for each of the years in the two-year period ended August 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Nitches, Inc. and subsidiaries as of August 31, 2004 and the results of their operations and their cash flows for the two-year period ended August 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Los Angeles, California
October 22, 2004

NITCHES, INC. AND SUBSIDIARIES
Consolidated Balance Sheets, Restated

| | August 31, | |
|--|---------------|--------------|
| | 2005 | 2004 |
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 192,000 | \$ 219,000 |
| Receivables: | | |
| Due from factor, net | 3,749,000 | 4,762,000 |
| Non-factored trade receivables, net | 473,000 | 732,000 |
| Due from affiliates and employees | 11,000 | 32,000 |
| Total receivables | 4,233,000 | 5,526,000 |
| Refundable income taxes | 212,000 | |
| Inventories | 4,582,000 | 3,373,000 |
| Deferred income taxes, current | 867,000 | 288,000 |
| Other current assets | 302,000 | 89,000 |
| Total current assets | 10,388,000 | 9,495,000 |
| Furniture, fixtures and equipment, net | 38,000 | 37,000 |
| Deferred income taxes, non-current | 10,000 | 12,000 |
| Other assets | 17,000 | 17,000 |
| Total assets | \$ 10,453,000 | \$ 9,561,000 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities: | | |
| Due to factor | \$ 3,131,000 | \$ 1,939,000 |
| Accounts payable | 2,276,000 | 1,366,000 |
| Accrued expenses | 640,000 | 519,000 |
| Income taxes payable | | 54,000 |
| Total current liabilities | 6,047,000 | 3,878,000 |
| Long term liabilities: | | |
| Loss on equity investment | 146,000 | 222,000 |
| Shareholders' equity: | | |
| Preferred stock, no par value; 25,000,000 shares authorized, no shares issued or outstanding | | |
| Common stock, no par value; 50,000,000 shares authorized; 1,171,169 shares in 2005 and 2004 issued and outstanding | 1,495,000 | 1,495,000 |
| Retained earnings | 2,765,000 | 3,966,000 |
| Total shareholders' equity | 4,260,000 | 5,461,000 |
| Total liabilities and shareholders' equity | \$ 10,453,000 | \$ 9,561,000 |

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

NITCHES, INC. AND SUBSIDIARIES
Consolidated Statements of Operations

| | Fiscal Year Ended August 31, | | |
|--|--|---------------|------------------|
| | 2005 | 2004 | 2003 |
| | (In thousands, except per share amounts) | | |
| Net sales | \$ 26,320 | \$ 32,179 | \$ 28,440 |
| Cost of goods sold | 20,534 | 22,783 | 21,856 |
| Gross profit | 5,786 | 9,396 | 6,584 |
| Selling, general and administrative | 8,175 | 8,389 | 7,663 |
| Income (loss) from operations | (2,389) | 1,007 | (1,079) |
| Other income | 460 | | 3 |
| Interest expense | (102) | (93) | (83) |
| Income (loss) from equity investment | (64) | 14 | (236) |
| Income (loss) before income taxes | (2,095) | 928 | (1,395) |
| Provision for (benefit from) income taxes | (894) | 371 | (425) |
| Net income (loss) | \$ (1,201) | \$ 557 | \$ (970) |
| Basic earnings per share | \$ (1.03) | \$.48 | \$ (0.83) |
| Diluted earnings per share | \$ (1.03) | \$.48 | \$ (0.83) |
| Weighted average number of common shares (000 s): | | | |
| Basic | 1,171 | 1,171 | 1,171 |
| Diluted | 1,171 | 1,171 | 1,171 |
| Number of common shares outstanding at year end | 1,171 | 1,171 | 1,171 |

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

NITCHES, INC. AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity

| | Common Stock | | Retained Earnings | Total Shareholders Equity |
|---------------------------------|--------------|--------------|----------------------|---------------------------------|
| | Shares | Amount | | |
| Balance, August 31, 2002 | 1,171,169 | \$ 1,495,000 | \$ 4,731,000 | \$ 6,226,000 |
| Net loss | | | (970,000) | (970,000) |
| Cash dividends | | | (352,000) | (352,000) |
| Balance, August 31, 2003 | 1,171,169 | 1,495,000 | 3,409,000 | 4,904,000 |
| Net income | | | 557,000 | 557,000 |
| Balance, August 31, 2004 | 1,171,169 | 1,495,000 | 3,966,000 | 5,461,000 |
| Net loss | | | (1,201,000) | (1,201,000) |
| Balance, August 31, 2005 | 1,171,169 | \$ 1,495,000 | \$ 2,765,000 | \$ 4,260,000 |

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

NITCHES, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows, Restated

| | Year ended August 31, | | |
|---|-----------------------|-------------|--------------|
| | 2005 | 2004 | 2003 |
| Cash flows from operating activities: | | | |
| Net income(loss) | \$ (1,201,000) | \$ 557,000 | \$ (970,000) |
| Adjustments to reconcile net income (loss) to net cash used by operating activities: | | | |
| Share of (income) loss from equity investment | 64,000 | (14,000) | 236,000 |
| Depreciation and amortization | 27,000 | 26,000 | 33,000 |
| Deferred income taxes | (577,000) | (55,000) | (79,000) |
| (Increase) decrease in due from factor | 1,013,000 | (2,598,000) | 1,942,000 |
| (Increase) decrease in trade receivables | 259,000 | (460,000) | 45,000 |
| (Increase) decrease in due from affiliates and employees | 21,000 | (4,000) | 82,000 |
| (Increase) decrease in income taxes refundable/payable | (266,000) | 520,000 | (348,000) |
| (Increase) decrease in inventories | (1,209,000) | 1,601,000 | 332,000 |
| (Increase) decrease in other current assets | (213,000) | (32,000) | 49,000 |
| Increase (decrease) in accounts payable and accrued expenses | 1,031,000 | 178,000 | (2,570,000) |
| | (1,051,000) | (281,000) | (1,248,000) |
| Cash flows from investing activities: | | | |
| Purchases of furniture, fixtures and equipment | (28,000) | (7,000) | (4,000) |
| Capital contribution in equity investment | (140,000) | | |
| | (168,000) | (7,000) | (4,000) |
| Cash flows from financing activities: | | | |
| Advances from factor | 1,192,000 | 397,000 | 1,532,000 |
| Dividends paid, common stock | | | (352,000) |
| | 1,192,000 | 397,000 | 1,180,000 |
| Net increase (decrease) in cash | (27,000) | 109,000 | (72,000) |
| Cash at beginning of year | 219,000 | 110,000 | 182,000 |
| | \$ 192,000 | \$ 219,000 | \$ 110,000 |
| Supplemental disclosures of cash flow information: | | | |
| Cash paid during the year: | | | |
| Interest | \$ 102,000 | \$ 93,000 | \$ 83,000 |
| Income taxes | \$ 118,000 | \$ 349,000 | \$ |

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

Nitches Inc, and Subsidiaries
Notes to the Consolidated Financial Statements

1. Description of Business

Nitches, Inc. (the Company) is a wholesale importer and distributor of clothing manufactured to its specifications and distributed in the United States under Company brand labels and retailer-owned private labels. The Company's product lines are women's sleepwear and western wear, men's casual wear and golf apparel, and men's and women's performance apparel.

2. Summary of Significant Accounting Policies

Principles of Consolidation:

The consolidated financial statements include the accounts of Nitches, Inc. and its wholly owned subsidiary, Nitches Far East Limited. All significant inter-company transactions and balances are eliminated in consolidation.

Financial Instruments:

Financial instruments consist of cash and cash equivalents, accounts receivable, and accounts payable. The carrying amount approximates fair value because of their short maturity.

Concentration of Credit Risk:

The Company sells a majority of its accounts receivable to a financial institution. Under the agreement, the financial institution purchases trade accounts receivable and assumes substantially all credit risks. This agreement is detailed in Note 5. The Company is responsible for following up on adjustments claimed by customers. Accounts that are not sold remain the credit risk of the Company. Such accounts are diverse and are subject to credit approval and ongoing evaluation by the Company. Management considers the credit risk with respect to all receivables to be low. Historically, the Company has not experienced significant loss due to uncollectible accounts receivable.

Cash balances are periodically maintained in amounts in excess of FDIC insured limits in high quality financial institutions. Management considers the risk of loss to be low.

Inventories:

Inventories are stated at the lower of cost (first-in, first-out method) or market.

Furniture, Fixtures and Equipment:

Furniture, fixtures and equipment are stated at cost. Depreciation is computed using the straight-line method based on the estimated useful lives of the related assets, which range from two to ten years. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful lives of the assets or the remaining term of the related lease. Maintenance and repair costs are charged to expense as incurred. When assets are retired or sold, the assets and accumulated depreciation are removed from the respective accounts and any profit or loss on the disposition is credited or charged to income.

Earnings Per Share:

The computation of net income per common share is based on the weighted average number of common shares outstanding plus common share equivalents arising from dilutive stock options, if any. The weighted average number of common shares and common share equivalents outstanding for basic and diluted earnings per share was 1,171,169 for fiscal 2005, 2004 and 2003.

Revenue Recognition:

The Company recognizes revenue at the time products are shipped based on its terms of F.O.B. shipping point, where risk of loss and title transfers to the buyer at time of shipment. The Company records sales in accordance with SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*. Under these guidelines, revenue is recognized when all of the following exist: persuasive evidence of a sale arrangement exists, delivery of the product has occurred, the price is fixed or determinable and payment is reasonably assured. Provisions are made currently for estimated product returns and sales allowances

Income Taxes:

The Company records income taxes using an asset and liability method. Under this method, deferred Federal and state income tax assets and liabilities are provided for temporary differences between the financial reporting basis and the tax-reporting basis of the consolidated assets and liabilities. Income taxes are further explained in Note 6.

Estimates:

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

Freight Costs:

Freight costs billed to customers for the handling and delivery of products to their locations are included in net sales. Freight costs incurred from third party delivery services are included in cost of goods sold. Freight costs of \$268,000, \$367,000 and \$245,000 for the years ended August 31, 2005, 2004 and 2003, respectively, are included in cost of goods sold.

Reclassification:

Certain items in the 2003 and 2004 cash flow statements have been reclassified to conform to the 2005 presentation.

Recently issued accounting pronouncements:

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS 154) which replaces APB Opinion No. 20 *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements-An Amendment of APB Opinion No. 28*. SFAS 154 requires retrospective application to prior periods financial statement of a voluntary change in accounting principal unless it is not practical. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 and is required to be adopted by the Company in the first quarter of fiscal 2007. Although the Company will continually evaluate its accounting policies, management does not currently believe adoption will have a material impact on the Company's results of operations, cash flows or financial position.

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 153, *Exchanges of Nonmonetary Assets* . (SFAS No. 153) which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 will be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not believe the adoption on will have a material impact on the Company's results of operations, cash flows or financial position.

3. Inventories

| | August 31, | |
|---------------------|---------------------|---------------------|
| | 2005 | 2004 |
| Fabric and trim | \$ 254,000 | \$ 141,000 |
| In-Transit | 1,530,000 | 1,225,000 |
| Finished goods | 2,883,000 | 2,092,000 |
| Markdown allowances | (85,000) | (85,000) |
| | <u>\$ 4,582,000</u> | <u>\$ 3,373,000</u> |

4. Furniture, Fixtures and Equipment

| | August 31, | |
|--|------------------|------------------|
| | 2005 | 2004 |
| Leasehold improvements | \$ 20,000 | \$ 7,000 |
| Computer equipment | 33,000 | 27,000 |
| Vehicles | 111,000 | 111,000 |
| Furniture, fixtures and other equipment | 38,000 | 28,000 |
| | <u>202,000</u> | <u>173,000</u> |
| Less accumulated depreciation and amortization | 164,000 | 136,000 |
| | <u>\$ 38,000</u> | <u>\$ 37,000</u> |

5. Accounts Receivable and Amounts Due to Factor

Pursuant to the terms of an agreement between Nitches and a factor, Nitches sells a majority of its trade accounts receivable to the factor on a pre-approved, non-recourse basis. The price at which the accounts are sold is the invoice amount reduced by the factor commission (.3% of the invoice amount) and all selling discounts. For accounts sold to the factor without recourse, the factor is responsible for collection, assumes all credit risk, and obtains all of the rights and remedies against the company's customers. For such accounts, payment is due from the factor upon the earlier of the payment of the receivable to the factor by the customer, or the maturity of the receivable (generally 180 days from the date of shipment to the customer). As of August 31, 2005, non-recourse receivables totaled \$3.8 million.

Trade accounts receivable not sold to the factor remain in the custody and control of the Company and the Company maintains all credit risk on those accounts as well as accounts which are sold to the factor with recourse. The combined credit risk for non-factored and recourse receivables as of August 31, 2005, totaled \$667,000.

The Company may request payment from the factor in advance of the collection date or maturity. Any such advance payments are assessed an interest charge through the collection date or maturity at the factor's prime rate less 1.5% (one and one half percent) per annum. The company's obligations with respect to advances from the factor are limited to the interest charges thereon. Advance payments are limited to a maximum of 85% (eighty-five percent) of eligible accounts receivable. The factoring agreement also provides for the issuance of irrevocable letters of credit for the Company's purchase of inventory in the normal course of its business. Letters of credit are subject to a \$6 million limit. All assets of the company collateralize the advances and letters of credit. The Company's Chairman has also provided a personal guaranty in connection with the factoring arrangement. The factoring agreement can be terminated by CIT on 30-days written notice.

Edgar Filing: NITCHES INC - Form 10-K/A

The status of the Company's trade accounts receivable and letters of credit are as follows:

| | August 31, | |
|--|--------------|--------------|
| | 2005 | 2004 |
| Receivables assigned to factor: | | |
| Non-recourse | \$ 3,827,000 | \$ 5,028,000 |
| Recourse | 110,000 | 121,000 |
| Allowance for customer credits and doubtful accounts | (188,000) | (387,000) |
| Due from factor, net | \$ 3,749,000 | \$ 4,762,000 |
| Non-factored accounts receivable | 557,000 | 837,000 |
| Allowance for customer credits and doubtful accounts | (84,000) | (105,000) |
| Trade receivables, net | \$ 473,000 | \$ 732,000 |
| Due to factor | \$ 3,131,000 | \$ 1,939,000 |
| Contingent liabilities for irrevocable letters of credit | \$ 3,520,000 | \$ 2,390,000 |

6. Income Taxes

The components of the provision/(benefit) for income taxes are as follows:

| | Year ended August 31, | | |
|---------------------|-----------------------|------------|--------------|
| | 2005 | 2004 | 2003 |
| Current: | | | |
| Federal | \$ (320,000) | \$ 346,000 | \$ (334,000) |
| State | 3,000 | 80,000 | (12,000) |
| Deferred | (317,000) | 426,000 | (346,000) |
| Provision/(Benefit) | \$ (894,000) | \$ 371,000 | \$ (425,000) |

Net deferred income tax assets at August 31, 2005 and 2004 consist of the tax effects of temporary differences related to the following:

| | August 31, | |
|---|------------|------------|
| | 2005 | 2004 |
| Current deferred assets: | | |
| Inventories | \$ 160,000 | \$ 140,000 |
| Sales returns and doubtful account reserves | 106,000 | 144,000 |
| Accrued compensation | 28,000 | 42,000 |
| Federal NOL benefit | 573,000 | |
| Other items | | (38,000) |
| | \$ 867,000 | \$ 288,000 |

Edgar Filing: NITCHES INC - Form 10-K/A

| | | | |
|------------------------------|----|-------------------|-------------------|
| Non-current deferred assets: | | | |
| Fixed assets | \$ | 10,000 | \$ 12,000 |
| | | <u> </u> | <u> </u> |
| | \$ | 10,000 | \$ 12,000 |
| | | <u> </u> | <u> </u> |

Edgar Filing: NITCHES INC - Form 10-K/A

Differences between the statutory Federal income tax rate and the effective tax rate as a percentage of pre-tax income are as follows:

| | Year ended August 31, | | |
|--|-----------------------|--------------|----------------|
| | 2005 | 2004 | 2003 |
| Statutory rate | (34.0)% | 34.0% | (34.0)% |
| State income taxes, net of Federal benefit | (5.8)% | 5.8% | (5.8)% |
| State NOL limitation | 0.0% | 0.0% | 2.0% |
| (Income)/loss on equity investment | (2.8)% | (0.5)% | 6.7% |
| Nondeductible entertainment expenses | 0.0% | 0.2% | 0.0% |
| Other items | (0.1)% | 0.5% | 0.6% |
| Effective rate | (42.7)% | 40.0% | (30.5)% |

The amount and expiration dates of net operating loss carry forwards are as follows:

| | Expiring August 31, | | |
|---------|---------------------|-----------|--------------|
| | 2014 | 2015 | 2025 |
| Federal | \$ | \$ | \$ 1,644,978 |
| State | 520,039 | 1,146,187 | |

7. Employee Benefit Plans

The Company has a 401(k) Savings Plan, whereby employees may make investments in various independent funds and Company stock. The Company may match employee contributions to this Plan on a discretionary basis or contribute on a profit sharing basis. The Company made no matching or profit sharing contributions to this Plan in fiscal 2005, 2004, or 2003.

8. Stock Options and Dividends

Stock Options

No stock options were outstanding as of August 31, 2005, 2004 or 2003. The Company does not have an active stock option plan.

Dividends

During fiscal 2005 and 2004 the Company did not declare a dividend. However, during fiscal 2003 the company declared and paid cash dividends of \$0.30 per share.

9. Leases

The Company has lease commitments expiring at various dates through September 2006, principally for real property and equipment. The aggregate minimum rental commitments for future years ending August 31 for all non-cancelable leases having initial or remaining terms of one or more years are as follows:

| | | |
|--------------|----|----------------|
| 2006 | \$ | 345,000 |
| 2007 | | 14,000 |
| Total | \$ | 359,000 |

The Company's leases for real property are generally subject to rent escalation based on increases in the consumer price or other indices with certain minimum and maximum increases. Rent expense, net of sublease income, was approximately \$406,000, \$391,000, and \$396,000, during fiscal 2005, 2004 and 2003, respectively.

10. Operating Segments and Major Customers

The Company's products comprise a single operating segment. No significant assets are maintained outside the United States. Sales are made to a variety of customers throughout the United States. Sales to one customer accounted for 53.1% of the Company's net sales in fiscal 2005. Two customers each accounted for 32.3% and 31.2%, respectively, of the Company's net sales in fiscal 2004.

Two major customers accounted for 32.7% and 14.1%, respectively, of the Company's trade receivable balance at August 31, 2005. While two different customers each accounted for 44.0% and 41.5% each of the Company's trade receivable balance at August 31, 2004.

11. Equity Investment

In October 2002, the Company acquired a 28% interest in Designer Intimates, Inc., which owns 100% of NAP, Inc., a New York-based intimate apparel company. Designer Intimates had acquired NAP from its founders and obtained a credit line of approximately \$12 million from HSBC which was later assumed by CIT, secured by the inventory and accounts receivable of NAP and the guarantees of shareholders of Designer Intimates. Nitches guaranteed \$3 million of this credit line and this guaranty formed the consideration from Nitches for its 28% ownership interest in Designer Intimates. In the event of a call on this guaranty by CIT, Nitches has a contract with the remaining shareholders of Designer Intimates to limit Nitches' exposure to 28% of the called value, subject to the maximum guaranty of \$3.0 million. At August 31, 2005, Designer Intimates had outstanding advances due to the factor in the amount of \$1.8 million, of which the Company's exposure was \$0.5 million or 28%.

Nitches reports any income or loss from the ongoing operation of Designer Intimates using the equity method of accounting, whereby Nitches' 28% interest in Designer Intimates is reported as a single line item on the Consolidated Statement of Operation. For fiscal year ended August 31, 2005, the Company recognized a loss of \$64,000 from the unconsolidated subsidiary. This loss is a non-cash loss and is not tax deductible by the Company. For that same period in fiscal 2005, Designer Intimates incurred a loss of \$228,000 on sales of \$45.7 million. Cumulative losses on this investment of \$146,000 and \$222,000 are shown as a liability on the consolidated balance sheet as of August 31, 2005 and 2004, respectively. During fiscal 2005 the Company contributed additional capital of \$140,000 to Designer Intimates.

Nitches has introduced Designer Intimates to the factories that Nitches uses for its own sleepwear product line. This provides access to a lower cost production base than Designer Intimates has had in Turkey where it has historically produced over ninety percent of its products which are predominantly robes and lounge wear. In an agreement with Designer Intimates, Nitches has produced a line of sleepwear under the Dockers label. This product contributed approximately \$9.0 million of sales for Nitches in fiscal year 2005. As of August 31, 2005, Nitches had a backlog of approximately \$4.1 million for this product line.

11. Equity Investment, continued

The audited condensed financial statements of the Company's equity method affiliate are summarized below:

**Designer Intimates, Inc.
Audited Consolidated Statements of Revenue and Expenses**

| | Fiscal years ended | |
|--|--------------------|-----------------|
| | August 31, 2005 | August 31, 2004 |
| Net Sales | \$ 45,679,000 | \$ 68,278,000 |
| Cost of sales | 36,254,000 | 53,464,000 |
| Gross profit | 9,425,000 | 14,814,000 |
| Selling, general and administrative expenses | 9,399,000 | 14,452,000 |
| Income from operations | 26,000 | 362,000 |
| Interest expense | 254,000 | 236,000 |
| Other income | | (123,000) |
| Income/(loss) before income taxes | (228,000) | 249,000 |
| Provision for income taxes | | 200,000 |
| Net income/(loss) | \$ (228,000) | \$ 49,000 |

11. Equity Investment, continued

Designer Intimates, Inc.
Audited Consolidated Balance Sheets

| | August 31 | |
|--|--------------|--------------|
| | 2005 | 2004 |
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 111,000 | \$ 120,000 |
| Due from factor | 73,000 | |
| Inventories | 1,837,000 | 5,301,000 |
| Prepaid expenses and other current assets | 89,000 | 87,000 |
| Deferred income taxes, current | 100,000 | 125,000 |
| | 2,210,000 | 5,633,000 |
| Total current assets | | |
| Fixed assets, net | 323,000 | 651,000 |
| Goodwill | 2,548,000 | 2,548,000 |
| Deferred income taxes, non-current | 100,000 | 75,000 |
| Other assets | 62,000 | 301,000 |
| | 5,243,000 | 9,208,000 |
| Total Assets | | |
| LIABILITIES AND SHAREHOLDERS DEFICIT | | |
| Current liabilities: | | |
| Due to factor | \$ | \$ 317,000 |
| Accounts payable | 4,743,000 | 8,561,000 |
| Income taxes payable | 65,000 | 350,000 |
| Accrued expenses and other current liabilities | 953,000 | 770,000 |
| | 5,761,000 | 9,998,000 |
| Total current liabilities | | |
| Shareholders' Deficit: | | |
| Common stock, 1,000 shares authorized, 300 shares issued and outstanding | 3,000 | 3,000 |
| Additional Paid-in Capital | 500,000 | |
| Deficit (beginning October 1, 2002) | (1,021,000) | (793,000) |
| | (518,000) | (790,000) |
| Total shareholders' deficit | | |
| | \$ 5,243,000 | \$ 9,208,000 |

Edgar Filing: NITCHES INC - Form 10-K/A

12. Quarterly Results of Operations (Unaudited)

The following is a summary of the quarterly results of operations for the years ended August 31, 2005 and 2004.

| | Three months ended | | | |
|--|--------------------|-------------|-----------|-----------|
| | November 30 | February 28 | May 31 | August 31 |
| (In thousands, except per share amounts) | | | | |
| Fiscal 2005 | | | | |
| Net sales | \$ 6,337 | \$ 6,521 | \$ 7,403 | \$ 6,059 |
| Gross profit | 1,648 | 1,263 | 1,595 | 1,280 |
| Net loss | (12) | (524) | (188) | (477) |
| Net loss per common share | \$ (0.01) | \$ (0.45) | \$ (0.16) | \$ (0.41) |
| Fiscal 2004 | | | | |
| Net sales | \$ 6,796 | \$ 9,683 | \$ 9,024 | \$ 6,676 |
| Gross profit | 1,731 | 3,060 | 2,719 | 1,886 |
| Net income (loss) | 488 | 285 | 83 | (299) |
| Net income (loss) per common share | \$ 0.42 | \$ 0.24 | \$ 0.07 | \$ (0.25) |

13. Subsequent Event

Subsequent to fiscal 2005, on October 24, 2005, the Company acquired the remaining seventy-two percent (72%) of the issued and outstanding stock of Designer Intimates, Inc., a Delaware corporation (Designer Intimates) which Nitches did not own, resulting in the Company owning one hundred percent (100%) of Designer Intimates. The aggregate purchase price for the acquisition was \$1,800,000. Nitches issued to the Sellers 180,000 restricted shares of its common stock at a value of \$5.10 per share and \$882,000 of preferred stock. The assets of Designer Intimates include finished goods inventory, customer lists, customer orders, trade names, brand licenses, brand distribution agreements, office leases in New York City and Atlanta, and office equipment, furniture and fixtures, all of which Nitches intends to continue to use.

14. Restatement

After filing its annual report on form 10-K for 2005, the Company reviewed its presentation of factored trade receivables and factor advances on the balance sheet and determined that, in accordance with generally accepted accounting principles, factor advances should be presented as a separate liability on the balance sheet and not on a net basis with factored accounts receivable. This amended report includes the restatement of the balance sheets and statements of cash flows to reflect this presentation. The changes are summarized in the tables below.

Balance Sheets

| | As previously reported | Adjustments | As restated |
|--------------------------|------------------------|----------------|-------------|
| August 31, 2005 | | | |
| Accounts receivable, net | \$ 1,091,000 | \$ (1,091,000) | \$ |
| Due from factor, net | | 3,749,000 | 3,749,000 |
| Trade receivables, net | | 473,000 | 473,000 |
| Due to factor | | 3,131,000 | 3,131,000 |
| August 31, 2004 | | | |
| Accounts receivable, net | \$ 3,555,000 | \$ (3,555,000) | \$ |
| Due from factor, net | | 4,762,000 | 4,762,000 |
| Trade receivables, net | | 732,000 | 732,000 |
| Due to factor | | 1,939,000 | 1,939,000 |

Consolidated Statements of Cash Flows

| | As previously reported | Adjustments | As restated |
|--|------------------------|----------------|-------------|
| Year ended August 31, 2005 | | | |
| (Increase) decrease in accounts receivable | \$ 1,272,000 | \$ (1,272,000) | \$ |

Edgar Filing: NITCHES INC - Form 10-K/A

| | | | | |
|--|----|-------------|----|-------------|
| (Increase) decrease in due from factor | | 1,013,000 | | 1,013,000 |
| (Increase) decrease in trade receivables | | 259,000 | | 259,000 |
| Year ended August 31, 2004 | | | | |
| (Increase) decrease in accounts receivable | \$ | (3,058,000) | \$ | 3,058,000 |
| (Increase) decrease in due from factor | | (2,598,000) | | (2,598,000) |
| (Increase) decrease in trade receivables | | (460,000) | | (460,000) |
| Year ended August 31, 2003 | | | | |
| (Increase) decrease in accounts receivable | \$ | 1,987,000 | \$ | (1,987,000) |
| (Increase) decrease in due from factor | | 1,942,000 | | 1,942,000 |
| (Increase) decrease in trade receivables | | 45,000 | | 45,000 |

Item 9 - Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

As reported in Nitches 8-K filed with the Commission on August 23, 2005, the Board of Directors of the Company dismissed Moss Adams LLP (Moss Adams) as the Company s independent registered public accounting firm and engaged the accounting firm of Berenson LLP (Berenson) to audit the Company s financial statements for the fiscal year ending August 31, 2005.

Item 9A - Controls and Procedures

Within 90 days prior to the date of this report, the Chief Executive and Financial Officer evaluated the effectiveness of the design and operation of the Company s disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, he concluded that the disclosure controls and procedures of the Company are effective in timely alerting of the material information required to be included in the periodic filings with the Securities and Exchange Commission and that the information required to be disclosed in these filings is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Commission.

PART III

Item 10 - Directors and Executive Officers of the Registrant

The following table sets forth certain information with respect to the Directors and executive officers of the Company:

| NAME | AGE | POSITION |
|---------------------|-----|---|
| Steven P. Wyandt | 61 | Chairman, Chief Executive Officer and Chief Financial Officer |
| Paul M. Wyandt | 37 | Director, President and Chief Operating Officer |
| Eugene B. Price II | 62 | Director (Independent) |
| Michael D. Sholtis | 58 | Director (Independent) |
| T. Jefferson Straub | 64 | Director (Independent) |

Mr. Steven Wyandt has been a director since 1989. He has been CEO of the Company since 1987. Mr. Wyandt was a director and Chairman of Body Drama, Inc. until August 31, 1998, which at the time was a wholly owned subsidiary of the Company but was merged into the Company as of that date. Steven Wyandt is the father of Paul Wyandt, an officer and director of the Company.

Mr. Paul Wyandt has been a director since 2001. He has been President and COO since 2001. He has been with the Company in the areas of finance, accounting, marketing and technology since 1997. Prior to that, he was Vice President of Finance and Operations of CMS Technologies, a company that designed hardware and software for personal computer security.

Mr. Price has been a director since 1973. From 1973 until he retired in May 1987, Mr. Price was a Vice President of the Company with primary responsibilities in sales and administration.

Mr. Sholtis is a seasoned retail executive with over 30 years of management experience with regional and national retailers including Belk Stores, McCraes, Sears, May Company and Allied Stores. He is a current member of the Retail, Textile and Marketing Board of the University of North Carolina, Greensboro.

Mr. Straub has served since 1975 as the president of Profit Management Consultants, a firm specializing in strategic planning, capital finance, and mergers & acquisitions. He also teaches courses in finance and international business as an adjunct professor at Webster University. Mr. Straub was previously a founder and executive team member of Fotomat Corporation, a retail film development company, from 1967-1975. Mr. Straub is Chairman of the Audit Committee and Financial Expert of the Audit Committee.

Mr. Price, Mr. Sholtis and Mr. Straub are independent directors as defined in NASD Rule 4200.

We have adopted a Code of Ethics and Business Conduct that applies to all of our directors, officers, and employees. The Code of Ethics is filed as Exhibit 14.1 to this report and is posted on our website at www.nitches.com. Amendments to, and waivers granted under, our Code of Ethics, if any, will be posted to our website as well.

Item 11 - Executive Compensation

Edgar Filing: NITCHES INC - Form 10-K/A

The following table shows the compensation provided to the Chief Executive Officer and each of the other most highly-compensated executive officers who served as such at the end of fiscal 2005 and whose annual compensation exceeds \$100,000:

32

| Name/Title Year | Long Term Compensation | | | | | | |
|------------------|------------------------|-------------|--------------------------------|-------------------------------------|---|-----------------------|-----------------------|
| | Annual Compensation | | | Awards | | Payouts | |
| | Salary \$ | Bonus \$ | Other Annual Comp. \$ | Restricted Stock Awards \$ | Securities Underlying Options/ SARs # | LTIP Payouts \$ | All Other Comp. |
| Steven P. Wyandt | | | | | | | |
| CEO & CFO | | | | | | | |
| 2005 | 250,000 | | | | | | |
| 2004 | 250,000 | | | | | | |
| 2003 | 250,000 | | | | | | |
| Paul M. Wyandt | | | | | | | |
| President & COO | | | | | | | |
| 2005 | 160,000 | | | | | | |
| 2004 | 160,000 | | | | | | |
| 2003 | 160,000 | | | | | | |

There were no stock options outstanding or granted during fiscal year 2005.

The Company extended an employment agreement with Steven P. Wyandt, effective September 1, 2001 through August 31, 2004. Pursuant to this agreement, Mr. Wyandt serves as Chief Executive Officer and Chief Financial Officer of the Company. The agreement provides for a base annual salary of \$250,000, or a higher amount as the Board of Directors may approve. In addition, Mr. Wyandt may receive a bonus at the discretion of the Board of Directors. No bonus was paid to Mr. Wyandt during fiscal 2003, 2004, or 2005. The agreement continues on a month-to-month basis after August 31, 2004.

The Company entered into an employment agreement with Paul M. Wyandt, effective September 1, 2001 through August 31, 2004. Pursuant to this agreement, Mr. Wyandt serves as President and Chief Operating Officer of the Company. The agreement provides for a base annual salary of \$160,000, or a higher amount as the Board of Directors may approve. In addition, Mr. Wyandt may receive a bonus at the discretion of the Board of Directors. No bonus was paid to Mr. Wyandt during fiscal 2003, 2004, or 2005. The agreement continues on a month-to-month basis after August 31, 2004.

All directors who are not employees of the Company receive \$12,000 annually, plus \$1,000 for attendance at each Board of Directors and Committee meeting and reimbursement of reasonable expenses. The \$1,000 fee is not paid for attendance at a Committee meeting that is held the same day the Board of Directors meets nor for participation in any meeting telephonically.

Compensation Committee

The Compensation Committee is responsible for setting base compensation, awarding bonuses and setting the number and terms of options for the Company's executive officers and approval of the number and terms of options for all other employees. The Committee establishes base salaries for executive officers at levels that it believes are sufficient to attract and retain such executives. The Committee may use independent survey reports for comparable companies to assist in establishing the base salaries. The Committee did not meet during fiscal year 2005.

Compensation Committee Interlocks and Insider Participation. The Committee consisted of Mr. Price and Mr. Sholtis. Neither Mr. Price nor Mr. Sholtis is an officer or employee of the Company.

Item 12 - Security Ownership of Certain Beneficial Owners and Management

The following table sets forth, as of February 10, 2006, certain information with respect to the beneficial ownership of Common Stock by (a) each person known by the Company to be the beneficial owner of more than 5% of its outstanding Common Stock, (b) any of the Company's directors and (c) all directors and officers as a group. Except as noted below, to the best of the Company's knowledge, each of such persons has sole voting and investment power with respect to the shares beneficially owned.

| Name and Address of Beneficial Owner (1)(2) | Number of Shares | Percent of Class Outstanding |
|--|------------------|------------------------------|
| Steven P. Wyandt (3) | 1,298,349 | 32.0% |
| Eugene B. Price II | 69,417 | 1.7% |
| All directors and current officers as a group (5 persons) | 1,367,766 | 33.7% |
| Haresh T. Tharani 1400 Broadway, 33 rd Floor New York, NY 10018 | 450,000 | 11.1% |

(1) Except as otherwise indicated, the address of each beneficial owner is c/o Nitches, Inc., 10280 Camino Santa Fe, San Diego, CA 92121.

(2) Except as otherwise indicated, the persons named in this table have sole voting and investment power with respect to all shares of common stock listed.

(3) A portion of the shares of Steven P. Wyandt are owned indirectly in Trusts, the terms of which establish sole voting power in Mr. Wyandt.

(4) Includes 300,000 restricted shares (adjusted for the 200% stock dividend of January 3, 2006) Mr. Tharani received as a result of the Company's acquisition of Designer Intimates, Inc.

Item 13 - Certain Relationships and Related Transactions

None.

Item 14 - Principal Accountant Fees and Services

Fees billed for professional services rendered by Berenson LLP for the annual audit of our annual financial statements for fiscal 2005 were \$60,598. The aggregate fees billed for professional services rendered by Moss Adams LLP for the review of fiscal 2005 financial statements included in our Forms 10-Q were \$41,167. Their aggregate fees billed for fiscal 2004 for the audit of our annual financial statements and review of our financial statements included in our Forms 10-Q were \$80,272. The aggregate fees billed for tax services, including tax planning and preparation during fiscal 2005 and fiscal 2004 were \$34,372 and \$30,835, respectively. The Company did not engage Berenson LLP or Moss Adams LLP on any other matters not otherwise included in the above categories in either fiscal 2005 or 2004.

PART IV**Item 15 - Exhibits, Financial Statement Schedules and Reports on Form 8-K**

(a) Documents filed as part of this report:

- The following consolidated financial statements of the Registrant are included as part of this report:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of August 31, 2005 and 2004;

Consolidated Statements of Income for the years ended August 31, 2005, 2004 and 2003;

Edgar Filing: NITCHES INC - Form 10-K/A

Consolidated Statements of Shareholders' Equity for the years ended August 31, 2005, 2004 and 2003;

Consolidated Statements of Cash Flows for the years ended August 31, 2005, 2004 and 2003;

Notes to Consolidated Financial Statements

2. The following financial statement schedules of the Registrant are included as part of this report:

Report of independent auditors on Schedule II

Schedule II - Valuation and Qualifying Accounts and Reserves

All other schedules are omitted because they are not required, are inapplicable or the information is otherwise shown in the financial statements or notes thereto.

3. The following exhibits are filed herewith or incorporated by reference as indicated. Exhibit numbers refer to Item 601 of Regulation S-K:

3.1 Articles of Incorporation of the Company, as amended (1)

3.2 Bylaws of the Company, as amended (2)

10.1 Form of Indemnification Agreement for Officers and Directors (1)

10.2 Asset Purchase Agreement and related agreements between the Company and Design and Source Holding Company, Ltd. effective July 1, 1995 (3)

14.1 Nitches, Inc. Code of Ethics and Business Conduct

(b) Exhibits and Reports on Form 8-K. None

Footnotes

- (1) Incorporated by reference from Registrant's Form 10-K filed on November 23, 1992 for the fiscal year ended August 31, 1992.
- (2) Incorporated by reference from Registrant's Form 10-K filed on November 23, 1988 for the fiscal year ended August 31, 1988.
- (3) Incorporated by reference from Registrant's Form 10-K filed on November 3, 1995 for the fiscal year ended August 31, 1995.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, there unto duly authorized.

Date: July 14, 2006

NITCHES, INC.

By: /s/ Steven P. Wyandt

Steven P. Wyandt, Chairman

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| | | |
|----------------------|---|---------------|
| /s/ Steven P. Wyandt | Chief Executive Officer (Principal Executive Officer), Chief Financial Officer (Principal Financial Officer) and Director | July 14, 2006 |
|----------------------|---|---------------|

Steven P. Wyandt

| | | |
|--------------------|--|---------------|
| /s/ Paul M. Wyandt | President, Chief Operating Officer (Principal Operating Officer), and Director | July 14, 2006 |
|--------------------|--|---------------|

Paul M. Wyandt

| | | |
|------------------------|----------|---------------|
| /s/ Eugene B. Price II | Director | July 14, 2006 |
|------------------------|----------|---------------|

Eugene B. Price II

| | | |
|---------------------|----------|---------------|
| /s/ Michael Sholtis | Director | July 14, 2006 |
|---------------------|----------|---------------|

Michael Sholtis

| | | |
|-------------------------|----------|---------------|
| /s/ T. Jefferson Straub | Director | July 14, 2006 |
|-------------------------|----------|---------------|

T. Jefferson Straub

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders
Nitches, Inc. and Subsidiaries
San Diego, California

Our audit of the consolidated financial statements of Nitches, Inc. and Subsidiaries referred to in our report dated October 14, 2005 appearing in item 8 in this Annual Report of Form 10-K also included an audit of the information for the year ended August 31, 2005 included in the financial statement schedule listed in item 15 of this Form 10-K. In our opinion, the information for the year ended August 31, 2005 included in the financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

Berenson LLP

New York, New York
October 14, 2005

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders
Nitches, Inc. and Subsidiaries
San Diego, California

Our audit of the consolidated financial statements of Nitches, Inc. and Subsidiaries referred to in our report dated October 22, 2004 appearing in item 8 in this Annual Report of Form 10-K also included an audit of the information for the years ended August 31, 2004 and 2003, included in the financial statement schedule listed in item 14(a) of this Form 10-K. In our opinion, the information for the years ended August 31, 2004 and 2003, included in the financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

MOSS ADAMS LLP

Los Angeles, California
October 22, 2004

NITCHES, INC.

Valuation and Qualifying Accounts and Reserves

| | Balance at Beginning of Year | Additions | | Deductions | Balance at End of Year |
|---|------------------------------------|-------------------------------------|---------------------------------|------------|---------------------------|
| | | Charged to Costs and Expenses | Charged to Other Accounts | | |
| Year ended August 31, 2003 | | | | | |
| Allowance for doubtful accounts & sales returns | \$ 237,000 | \$ 663,000 | | \$ 351,000 | \$ 549,000 |
| Inventory markdown allowance | \$ 75,000 | \$ 324,000 | | \$ 259,000 | \$ 140,000 |
| Year ended August 31, 2004 | | | | | |
| Allowance for doubtful accounts & sales returns | \$ 549,000 | \$ 330,000 | | \$ 387,000 | \$ 492,000 |
| Inventory markdown allowance | \$ 140,000 | \$ 118,000 | | \$ 173,000 | \$ 85,000 |
| Year ended August 31, 2005 | | | | | |
| Allowance for doubtful accounts & sales returns | \$ 492,000 | \$ 318,000 | | \$ 538,000 | \$ 272,000 |
| Inventory markdown allowance | \$ 85,000 | \$ 61,000 | | \$ 61,000 | \$ 85,000 |

EXHIBIT INDEX

| Exhibit Number | Exhibit |
|---------------------------|---|
| *3.1 | Articles of Incorporation of the Company, as amended |
| *3.2 | Bylaws of the Company, as amended |
| *10.1 | Form of Indemnification Agreement for Officers and Directors |
| *10.2 | Asset Purchase Agreement and related agreements between the Company and Design and Source Holding Company, Ltd effective July 1, 1995 |
| 14.1 | Nitches, Inc. Code of Ethics and Business Conduct |
| 31 | Certification required under Section 302 |
| 32 | Certification required under Section 906 |

* Incorporated by reference