NEXT INC/TN
Form 10-Q
October 12, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X]

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended August 31, 2007

OR

[ ]

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 0-25247

NEXT, INC.

(Exact name of small business issuer as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**95-4675095** (I.R.S. Employer Identification No.)

7625 Hamilton Park Drive, Suite 12

Chattanooga, Tennessee 37421

(Address and zip code of principal executive offices)

Registrant s telephone number, including area code: **(423) 296-8213**

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 [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [X]

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

As of August 31, 2007 there were 19,641,142 shares of the registrant s common stock issued and outstanding.

NEXT, INC.

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Part I FINANCIAL INFORMATION

Item 1.

Financial Statements

NEXT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	August 31, 2007 (unaudited)	December 1, 2006 (audited)
Assets		
Current assets:		
Cash	$ 25,677	$ 80,700
Accounts receivable, net of allowances for doubtful accounts and contractual allowances of $293,501 and $235,876, respectively	4,229,971	6,705,812
Notes receivable	32,474	37,707
Inventories	5,382,243	4,026,565
Prepaid expenses	286,504	373,183
Other current assets	162,513	449,081
Deferred taxes, current		400,000

Total current assets	10,119,382	12,073,048
Property, plant and equipment, net	2,371,671	2,662,838
Goodwill	4,369,825	4,369,825
Notes receivable	9,852	32,504
Deferred taxes	1,094,908	176,628
Other assets, net	1,175,086	1,444,080
Total Assets	$ 19,140,724	$ 20,758,923
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 2,077,657	$ 3,217,014
Accrued expenses and other current liabilities	1,575,682	1,025,848
Short-term debt and current maturities	3,296,667	860,866
Loan from stockholders	200,000	200,000
Line of credit	4,598,077	4,217,238
Total current liabilities	11,748,083	9,520,966
Long-term debt, less current maturities		3,235,785

Loan from stockholders, less current maturities	300,000	300,000
Total liabilities	12,048,083	13,056,751
Stockholders equity	7,092,641	7,702,172
Total Liabilities and Stockholders Equity	$ 19,140,724	$ 20,758,923

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

NEXT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended	
	August 31, 2007 (unaudited)	September 1, 2006 (unaudited)
Net sales	$ 5,858,225	$ 8,876,376
Cost of sales	4,020,176	6,271,344
Gross profit	1,838,049	2,605,032
General, administrative, and selling expenses	1,414,919	1,966,177
Operating income	423,130	638,855
Interest	(156,797)	(237,636)
Other income (expense)	37,512	(53,249)
Income before income taxes	303,845	347,970
Provision for income taxes	100,437	128,053
Net income	$ 203,408	$ 219,917
Net income per share, basic and diluted	$ .01	$ .01
Weighted average shares outstanding, basic	19,529,254	18,371,751

Weighted average shares outstanding, diluted		19,626,449		18,490,322

	Nine Months Ended			
	August 31, 2007		September 1, 2006	
	(unaudited)		(unaudited)	
Net sales	$	11,641,458	$	18,550,417
Cost of sales		8,217,214		12,908,490
Gross profit		3,424,244		5,641,927
General, administrative, and selling expenses		4,197,933		4,966,353
Operating income (loss)		(773,689)		675,574
Interest		(479,748)		(580,627)
Other expense		(23,036)		(106,750)
Loss before income taxes		(1,276,473)		(11,803)
Benefit for income taxes		(518,280)		(2,982)
Net loss	$	(758,193)	$	(8,821)
Net loss per share, basic and diluted	$	(0.04)	$	

Weighted average shares outstanding, basic and diluted	18,903,423	18,396,846

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

NEXT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	August 31, 2007 (unaudited)	September 1, 2006 (unaudited)
Cash flows from operating activities:		
Net loss	$ (758,193)	$ (8,821)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	492,816	586,396
Noncash compensation	1,517	1,517
Noncash fees	45,934	11,368
Loss (gain) on sale of assets	(11,473)	48,310
Bad debt recovery	(9,200)	(13,922)
Deferred taxes	(518,280)	(2,982)
Changes in operating assets and liabilities:		
Accounts receivable	2,485,041	(887,811)
Notes receivable	27,885	29,765
Inventories	(1,355,678)	677,857
Prepaid expenses	116,679	(152,143)
Other assets	(73,432)	25,914

Accounts payable	(1,139,357)	935,346
Accrued expenses and other liabilities	549,834	921,826
Total adjustments	612,286	2,181,441
Net cash provided by (used in) operating activities	(145,907)	2,172,620
Cash flows from investing activities:		
Purchases of property, plant and equipment	(19,867)	(47,593)
Cash received from proceeds on sale of asset	112,500	4,700
Cash paid for intangible assets	(13,815)	(167,680)
Net cash provided by (used in) investing activities	78,818	(210,573)
Cash flows from financing activities:		
Revolving credit facility, net	380,839	(2,231,565)
Proceeds from loans and notes payable		912,000
Repayments of long term debt, loans and notes payable	(368,773)	(360,134)
Fees paid for investment transaction		(28,008)
Issuance of common stock for investment transaction		5,250
Net cash provided by (used in) financing activities	12,066	(1,702,457)

Net increase (decrease) in cash		(55,023)		259,590
Cash, beginning of period		80,700		152,601
Cash, end of period	$	25,677	$	412,191
Supplemental Information:				
Cash paid during the period for interest	$	420,774	$	565,223
Cash paid during the period for income taxes	$	6,248	$	
Non-Cash Investing and Financing Activities:				
Equity securities issued in payment of debt	$	431,212	$	
Equity securities retired in payment of note receivable	$	360,000	$	510,000
Equity securities issued in payment of services	$	30,000	$	
Equity securities retired to reduce vendor obligation	$		$	23,570

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

NEXT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1.

Organization and Operations of Company

Next, Inc. (the Company) is the parent company of two wholly owned subsidiaries: (i) Next Marketing, Inc. (Next Marketing), and (ii) Choice International, Inc. (Choice). The Company is a creative and innovative sales and marketing organization that designs, develops, markets and distributes licensed products and imprinted sportswear primarily through key licensing agreements and the Company s own proprietary designs.

2.

Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements contained herein have been prepared in accordance with generally accepted accounting principles for interim financial statements, the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. (Prior to 2007, the Company filed quarterly reports on Form 10-QSB and therefore, the condensed consolidated financial statements therein were prepared in accordance with the instructions to Form 10-QSB and Item 310 of Regulation S-B in addition to generally accepted accounting principles for interim financial statements.) Accordingly, these financial statements do not include all the information and footnotes required by generally accepted accounting principles for annual financial statements. In addition, certain comparative figures presented have been reclassified to conform the prior year s data to the Company s current financial statements. In the opinion of management, the accompanying condensed consolidated financial statements contain all the adjustments necessary (consisting only of normal recurring accruals and adjustments) to fairly present the financial position of the Company at August 31, 2007, and December 1, 2006, and its results of operations and cash flows for the three months and nine months ended August 31, 2007, and September 1, 2006. Operating results for the three and nine months ended August 31, 2007, are not necessarily indicative of the results that may be expected for the fiscal year ending November 30, 2007. These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company s latest shareholders annual report (Form 10-KSB).

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company balances and transactions have been eliminated.

Customer Base and Credit Concentration

The Company has developed a large, diverse, and distinguished customer base of traditional retailers that include national as well as large regional chains, specialty retailers, corporate accounts, college bookstores, motor sports, souvenir and gift shops, and golf shops. This expansion has been achieved through the acquisitions of several smaller enterprises, and their respective customer bases, the introduction of additional major product lines and distribution channels, such as the Motor Sports Division, which sells to a national auto dealer market consisting of approximately 9,000 potential customers, as well as expansion of its traditional national retail merchant customer base. In the nine months ended August 31, 2007, sales to the Company s two largest customers accounted for 74% of total sales. In the nine months ended September 1, 2006, sales to the Company s top four customers accounted for 75% of total sales. The Company s management believes that the Company s credit risk exposure is limited based on current information available with respect to the financial strength of its customers and previously recorded reserves. Such estimates could change in the future.

The Company is subject to seasonality in its sales cycle due to the amount of college-licensed products. The seasonality of sales results in 60 to 80 percent of the Company s revenues being generated in the third and fourth quarters.

New Pronouncements

The Securities and Exchange Commission has issued a final rule on the Internal Control over Financial Reporting in Exchange Act Periodic Reporting of Non-Accelerated Filers and newly Public Companies . The final rules set the dates to comply with the internal control reporting requirements mandated by Section 404 of the Sarbanes-Oxley Act of 2002. Non-accelerated filers must provide managements assessment regarding internal control over financial statements in its annual report for fiscal years ending after December 15, 2007 which will be the Company s November 28, 2008 fiscal year end and must comply with the auditor attestation requirement in fiscal years ending after December 15, 2008, which will be the Company s November 27, 2009 fiscal year end. The Company plans to be in full compliance with these internal control reporting requirements by the effective dates and has begun a detailed review of its internal control environment.

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS No. 159). This statement permits an entity to choose to measure many financial instruments and certain other items at fair value. The statement permits all entities to choose to measure eligible items at fair value at specified election dates. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company does not believe that adoption of this statement will have a material impact on its consolidated financial position or result of operations.

In September 2006, the FASB issued Statement No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an Amendment of FASB Statements No. 87, 88, 106 and 132(R) (SFAS No. 158). This statement requires an employer to recognize in its financial statements the funded status of a defined benefit plan, determine the funded status at the end of the employer s fiscal year and recognize changes in the fund status of a defined postretirement plan in the year a change occurs. SFAS No. 158 becomes effective in phases beginning with financial statements issued for the fiscal years beginning after December 15, 2006 and completed by financial statements issued for the fiscal years beginning after December 15, 2008. The Company does not believe that adoption of this statement will have a material impact on its consolidated financial position or result of operations.

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements, (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. Accordingly, SFAS No. 157 does not require any new fair value measurements, but will change current practice for some entities. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will apply this standard prospectively. The Company is studying this pronouncement, but currently believes it will not have a material effect on the Company s consolidated financial statements.

In June 2006, the FASB published Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109, (Interpretation No. 48). This interpretation requires companies to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. Interpretation No. 48 also provides guidance on derecognition classification, accounting in interim periods, and disclosure requirements for tax contingencies. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company does not believe that the application of Interpretation No. 48 will have a material effect on the Company s results of operations or financial position.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 (SFAS No. 155). Among other things, SFAS No. 155 allows financial statement preparers to elect fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. This statement also eliminates the exemption from applying SFAS No. 133 to interests in securitized financial assets. SFAS No. 155 is effective for all financial instruments acquired or issued by the Company after the beginning of an entity s first fiscal year beginning after September 15, 2006. The Company does not believe that adoption of this statement has had a material impact on its consolidated financial position or result of operations.

3.

Inventories

Inventories are valued at the lower of cost or market. Cost is determined by the first-in, first-out method, and market represents the lower of replacement cost or net realizable value. Inventories as of August 31, 2007 and December 1, 2006, consisted of the following:

		August 31, 2007		December 1, 2006
Raw materials	$	2,739,379	$	2,657,611
Finished goods		2,642,864		1,368,954

$	5,382,243	$	4,026,565

4.

Income Taxes

Income taxes have been computed in accordance with SFAS No. 109, Accounting for Income Taxes. This standard requires, among other things, recognition of future tax expenses or benefits, measured using enacted tax rates, attributable to taxable or deductible temporary differences between financial statements and income tax reporting bases of assets and liabilities.

The ultimate realization of deferred tax assets is dependent upon the attainment of forecasted results of operations. Management has taken these and other factors into consideration in recording the deferred tax estimate. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at August 31, 2007 and December 1, 2006, are as follows:

		August 31, 2007		December 1, 2006
Assets:				
Accounts receivable allowance	$	13,404	$	4,185
Net operating loss carryforwards		1,325,716		882,342
Total deferred tax assets	$	1,339,120	$	886,527
Liabilities:				
Property, plant and equipment	$	188,252	$	240,034
Goodwill and other intangibles		55,960		69,865
Total deferred tax liabilities	$	244,212	$	309,899
Deferred taxes, net	$	1,094,908	$	576,628
Current	$		$	400,000
Noncurrent	$	1,094,908	$	176,628

5.

Short-Term and Long-Term Debt

Short-term and long-term debt at August 31, 2007 and December 1, 2006 consisted of the following:

	August 31, 2007		December 1, 2006	
	Short Term	Long Term	Short Term	Long Term
Revolving credit facility	$ 4,598,077	$	$ 4,217,238	$
Notes payable	3,496,667	300,000	1,060,866	3,535,785
Total	$ 8,094,744	$ 300,000	$ 5,278,104	$ 3,535,785

Various assets collateralize all of the Company s debt and certain amounts are guaranteed by its principal stockholders.

The Company signed a new credit facility for a $7,500,000 line of credit with National City Bank on January 31, 2007 for two years, expiring on January 31, 2009. The interest rate on the facility is prime plus or minus .25% (depending on certain financial ratios being met), with advance rates of 85% on accounts receivable and 60% on inventory, and also includes quarterly financial covenants. The agreement provides for monthly payments of interest which, as of August 31, 2007, is calculated at the published prime rate plus .25% (8.25% was the published rate at August 31, 2007). The loan is collateralized by accounts receivable, inventory, and limited personal guarantees of the Company s Chief Executive Officer and one board member.

As of June 1, 2007, the Company was not in compliance with financial covenants contained in the credit facility referenced in the above paragraph, and has been informally advised by National City Bank that these violations will be waived with full reservation of rights so long as the Company meets revised and specific performance criteria, which as of the date of this Form 10-Q have not been finalized. Additionally, First Federal Savings Bank of Wabash has informally agreed to the same waiver as National City Bank and on substantially similar terms. Discussions with both banks have continued frequently throughout the third quarter and the Company continues to pay its bills in a timely manner. It has not defaulted on any payments that are due anyone and does not anticipate doing so at the date of this Form 10-Q. The bank loans are within the borrowing base formula and specifically, the credit facility referred to in the above paragraph had an available balance of approximately $1.8 million as of August 31, 2007. The

Company s use of this credit facility has been as it would have been under normal circumstances as if the covenant violations had not occurred. There are no covenants with any other lenders to the Company.

In accordance with EITF 86-30 and related guidance, the Company has evaluated the above referenced waivers and concluded that the related notes payable to First Federal Savings Bank of Wabash should be reclassified as current debt at this time. The Company has carried the National City Bank credit facility as a current liability since its inception in accordance with EITF 95-22, Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements That Include both a Subjective Acceleration Clause and a Lockbox Agreement.

On November 30, 2006, the Company entered into a subordinated loan agreement with Next Investors, LLC for $500,000, to replace an agreement originally executed on July 20, 2005. The purpose of this loan was to provide working capital to be repaid out of future cash flows. The loan has an interest rate of prime plus .25% and a maturity date of November 30, 2008. Next Investors, LLC principal partners are comprised of one director and two significant shareholders of the Company. As of August 31, 2007, interest expense on this loan totaled $10,743 and $32,229 for the three and nine months then ended, respectively, and accrued interest was $32,084. As of September 1, 2006, interest expensed and accrued for this loan totaled $9,479 and $28,646, respectively, for the three and nine months then ended. Under the terms of a subordination agreement among National City Bank, Next Investors, LLC and the Company, payments due under the agreement are to be suspended in the event of a default under the credit facility between National City Bank and the Company, and that upon notice from National City Bank to Next Investors, LLC, the terms of the subordinated loan agreement must be suspended and Next Investors, LLC will not be able to declare a default, renegotiate the terms of the note, or otherwise take any action until such time as National City Bank declares the Company to be in compliance with a new agreement or has been paid in full by the Company.

On April 6, 2006, the Company entered into a Subscription Agreement for Convertible Notes and Warrants with the following investors: DKR Soundshore Oasis Holding Fund Ltd., Alpha Capital Aktiengesellschaft, Monarch Capital Fund, Ltd., Iroquois Master Fund, Ltd., and Bluegrass Growth Fund, LP (collectively, the Investors), pursuant to which the Company issued to the Investors, as a group, $984,960 in principal amount of convertible promissory notes (the Notes) and warrants (the Warrants) to purchase 849,103 shares of common stock of the Company (the Common Stock). The Notes require equal monthly payments of cash or stock in the amount of $86,184 over a 12-month period starting 115 days after closing and will be fully subordinated to the Company s senior lenders. The Notes are convertible into a total of 1,698,207 shares of Common Stock at a conversion rate of $.58 in principal amount of the Notes per share. The warrants have a three-year term and an exercise price of $.68 per share of Common Stock. The Company has filed a registration statement with the Securities and Exchange Commission for the offer and sale by the Investors of the Common Stock underlying both the Notes and Warrants. In connection with these transactions, the Company issued to JPC Capital Partners, Inc., as placement agent, warrants to purchase 152,838 shares of Common Stock on the same terms as the Warrants issued to the Investors. At August 31, 2007 the notes had been repaid in full.

6.

Contingencies

From time to time, the Company is a party to litigation arising in the normal course of its business operations. In the opinion of management, after consulting with legal counsel, it is not anticipated that the matters will have a material adverse impact on the Company s financial condition, liquidity or results of operations.

7.

Stockholders Equity

Stockholders equity was comprised of the following:

	August 31, 2007	December 1, 2006
Common stock, $.001 par value; 100,000,000 shares authorized, 19,641,142 and 18,626,029 shares issued and outstanding at August 31, 2007 and December 1, 2006, respectively	$ 19,641	$ 18,626
Additional paid-in capital	7,424,719	7,278,589
Retained earnings (deficit)	(325,430)	432,763
Unearned compensation	(26,289)	(27,806)
Total stockholders equity	$ 7,092,641	$ 7,702,172

On February 27, 2007, the Company s former Chief Executive Officer, William B. Hensley, III, remitted 600,000 shares of Next, Inc. common stock to satisfy a promissory note executed for $360,000 to purchase certain licenses. These shares were cancelled and taken out of circulation. The transaction was valued at the market price of the stock on November 28, 2006, pursuant to the terms of a purchase agreement dated November 28, 2006, as amended. Pursuant to the terms of the purchase agreement, Mr. Hensley elected on February 27, 2007, to deliver shares of common stock of the Company to satisfy the promissory note.

8.

Earnings (Loss) Per Share

The Company accounts for earnings (loss) per share (EPS) in accordance with SFAS No. 128, Earnings Per Share. SFAS No. 128 requires the presentation of basic and fully diluted EPS. Basic and diluted EPS for the three and nine months ended August 31, 2007 and September 1, 2006, are calculated on the basis of the weighted average number of common shares outstanding.

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	Three months ended	
	August 31, 2007	September 1, 2006
Numerator:		
Net income	$ 203,408	$ 219,917
Denominator:		
Basic weighted average common shares	19,529,254	18,371,751
Effect of dilutive stock options, warrants, and contingent acquisition related shares	97,195	118,571
Denominator for diluted earnings per share	19,626,449	18,490,322
Basic and diluted earnings per share	$ 0.01	$ 0.01

	Nine months ended	
	August 31, 2007	September 1, 2006
Numerator:		
Net loss	$ (758,193)	$ (8,821)
Denominator:		
Basic weighted average common shares	18,903,423	18,396,846
Effect of dilutive stock options, warrants, and contingent acquisition related shares		
Denom		