

NEXT INC/TN  
Form 10KSB/A  
February 16, 2005

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-KSB/A**

**(Mark One)**

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

**For the Fiscal Year Ended November 30, 2004**

Or

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

**Commission File Number 000-25247**

**NEXT, INC.**

**(Exact name of 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**

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**Chattanooga, Tennessee 37421**

**(Address and zip code of principal executive offices)**

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

**Securities registered pursuant to Section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$.001 par value**

Check whether the issuer (1) 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 issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of issuer's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

The issuer's revenue for the fiscal year ended November 30, 2004 was \$21,518,753.

As of February 10, 2005 the aggregate market value of the Company's common stock was approximately US \$ 14,424,429 which value, solely for the purposes of this calculation, excludes common stock held by the Company's affiliates, including major shareholders, officers, and directors. Such exclusion should not be deemed a determination or an admission by the issuer that all such individuals are, in fact, affiliates of the issuer.

The number of shares of the Issuer's common stock issued and outstanding as of February 10, 2005 was 18,586,286.

## FORWARD LOOKING STATEMENTS

In addition to the historical information contained herein, this report contains forward-looking statements that are subject to risks and uncertainties. Forward-looking statements are not based on historical information but relate to future operations, strategies, financial results or other developments. Forward-looking statements are necessarily based upon estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and many of which, with respect to future business decisions, are subject to change. Certain statements contained in this Form 10-KSB, including, without limitation, statements containing the words believe, are of the opinion that, anticipate, estimate, expect, and words of similar import, constitute forward-looking statements. You should not place any undue reliance on these forward-looking statements.

You should be aware that our actual growth and results could differ materially from those contained in the forward-looking statements due to a number of factors, which include, but are not limited to the following: the special risk factors set forth in Part I, Item 1, Risk Factors; the risks and uncertainties set forth below; economic and business conditions specific to the promotional products and imprinted sportswear industry; competition and the pricing and mix of products offered by us and our competitors; style changes and product acceptance; relations with and performance of suppliers; our ability to control costs and expenses; our ability to effectively communicate with our customers and to penetrate their chosen distribution channels; access to capital; foreign currency risks; risks associated with our entry into new markets or distribution channels; risks related to the timely performance of third parties, such as shipping companies, including risks of strikes or labor disputes involving these third parties; our ability to maintain satisfactory relationships with our banking partners; political and trade relations; the overall level of consumer spending; global economic conditions, political instability and additional threatened terrorist attacks and responses thereto, including war. There may be other factors not mentioned above or included elsewhere in this report that may cause actual results to differ materially from any forward-looking information. You should not place undue reliance on these forward-looking statements. We assume no obligation to update any forward-looking statements as a result of new information, future events or developments, except as required by applicable securities laws.

NEXT, INC.

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## PART I

### ITEM 1.

#### BUSINESS

**BUSINESS DEVELOPMENT.** Next, Inc., a Delaware corporation, was formed January 2, 1987. It has five wholly owned operating subsidiaries: (i) Next Marketing Inc., a Delaware corporation ( Next Marketing ), (ii) Blue Sky Graphics, Inc., a Delaware corporation ( Blue Sky ), (iii) CMJ Ventures, Inc., a Florida corporation ( CMJ ), (iv) Lil Fan, Inc., a Delaware corporation ( Lil Fan ), and (v) Choice International Inc., a Delaware corporation ( Choice ). All references herein to the Company, we, us, our or Next refer to Next, Inc. and its subsidiaries.

**The Company.** The Company, as it currently operates, commenced its operations on February 1, 2002, after the completion of a stock exchange between Sporting Magic, Inc., a Delaware corporation, and Next, Inc., a Delaware corporation (the Exchange ). Following the Exchange and until December 27, 2002, the Company operated under the name Sporting Magic, Inc., at which time Next, Inc. was merged with and into Sporting Magic, Inc. and the name Sporting Magic, Inc. was changed to Next, Inc.

**The Subsidiaries.** Blue Sky and Next Marketing became indirect subsidiaries of the Company at the time of the Exchange and on December 27, 2002, following the merger between Sporting Magic, Inc. and Next, Inc., became wholly owned subsidiaries of the Company. Blue Sky and Next Marketing (and their respective predecessors) have been in existence since 1989 and 1997, respectively, and were prior to the Exchange owned and controlled by two of the Company's principal stockholders. CMJ became a subsidiary of the Company on June 1, 2002 pursuant to the terms of an Agreement and Plan of Merger dated as of March 1, 2002, as amended on May 16, 2002 and May 15, 2003. On July 31, 2003, the Company acquired substantially all of the assets of Lil Fan, Inc., the right to sell all items previously sold by Stan Howard & Associates, and Stan Howard & Associates, Inc. through a subsidiary that is now Lil Fan. On October 31, 2004, the Company acquired substantially all of the assets of Choice, the right to purchase goods through an international source, and the right to sell all items through a customer base previously sold by the principals through a subsidiary that is now Choice.

**THE BUSINESS.** The Company is a creative and innovative sales and marketing organization that designs, develops, markets and distributes licensed and branded promotional products and imprinted sportswear primarily through key licensing agreements and the Company's own proprietary designs.

The Company's management ( Management ) believes that there are substantial growth opportunities in the promotional products and imprinted sportswear industries and that the Company is well positioned to take advantage of these growth opportunities. Management believes that the Company has an excellent reputation in the marketplace as a result of its ability to provide quality products and services and on-time delivery at competitive prices.

The Company's licensed and proprietary products include the following:

§

Approximately 200 licenses and agreements to distribute its **Cadre Athletic™** and **Campus Traditions USA™** line for most major colleges and universities in the U.S.;

§

Licensing agreements with **Chevy®**, **Pontiac®**, **Hummer®**, **Cadillac®**, **Dodge®**, **GMC®**, **Chrysler®**, **Plymouth®**, **Jeep®** and **Ford®** for their respective "branded" logos for the **RPM Sports USA™** motor sports line, targeting the automotive dealership network, and automotive venue markets;

§

Proprietary designs including **American Biker™**, **American Wildlife™**, **Ragtops Sportswear™**, **Campus Traditions USA™** and **Cadre Athletic™**, among others;

§

Licensing and distribution agreements with **Sturgis Bike Rally**, **Professional Bull Riders**, **James Dean 50th commemorative anniversary**, **the 3 Stooges**, and **Fellowship of Christian Athletics**.

The Company is continually reviewing additional licensing programs and proprietary designs to further expand its licensing program and proprietary design portfolio.

**OPERATIONS.** The Company is one of the larger companies in the highly fragmented licensed promotional products and imprinted sportswear industries. The Company has implemented its strategy of The Total Solution Company to meet its customers key requirements including: art design and development, manufacturing (for imprinted sportswear), sourcing (for distributed products), warehousing and fulfillment. We believe that the following strengths, among others, have contributed to our past success and may provide us with a distinctive ongoing competitive advantage:

**High quality, cost effective imprinted sportswear.** Imprinted sportswear is produced both domestically and offshore. For large runs with long lead times, it is economically advantageous to produce the imprinted sportswear in countries where the cost of labor is lower than in the United States. Management believes that the Company does an excellent job of costing, and effectively sourcing its products from international suppliers. The Company's facility in Wabash, Indiana, was set-up specifically to handle situations where it is not practical to produce imprinted sportswear offshore such as: (a) for customized imprinted sportswear that, due to the uniqueness of the product, is not suited for the standardized long runs of offshore production, (b) for hot market reorders of just-in-time inventory such as for major sporting events, and (c) for demand that exceeds forecasts leading to the need for quick replenishment orders. The Wabash facility, with the capability to produce both imprinted and embroidered products, was organized by industry experts incorporating a sophisticated inventory management system with emphasis on automation of the manufacturing process effort, to minimize costs, cycle time and waste. The Wabash facility substantially reduces our reliance on outside sourcing, enabling us to reduce costs, shorten delivery time and enhance quality control of our products.

**Excellent design and merchandising staff.** We believe that licensed branded products are an established and significant growth category within our industry. The ability to deliver unique product offerings on a timely basis is key to the future success and expansion of our branded licensed revenue. The Company believes that it possesses one of the most creative and innovative design, merchandising and product development capabilities within the industry. The Company's design and merchandising staff determines, in partnership with our customers, the product strategy and is responsible for creating innovative products for our branded license and proprietary products lines. Management believes that this partnership provides stability in the design environment and consistency in our product variety and offers our customers flexibility in their product selection and timeliness of product delivery. The Company has been successful in significantly reducing the time requirements needed for the design, sourcing and delivery of products to substantially less than the industry norm. This enables us to provide a wide variety of products with greater acceptability in the marketplace within a reduced lead-time. Our partnerships with key suppliers further enhance our ability to develop and deliver our distinctive and innovative products quicker. In 2004, key suppliers included DZ Trading, Inc. and Choice Apparel, Inc.

**Upscale brand identity.** The Company offers a style of products that is built on quality and strong imagery. Our marketing themes revolve around college and university brands, motor sports, outdoor lifestyle, motorcycle biking, fishing, water sports, and other leisure pursuits designed to appeal to many of our target customers. We reinforce our upscale brand image at the retail level with specialized planograms and displays that present our lines as distinctive

collections. The Company's target is an upscale consumer in casual settings, college and sporting activities, or relaxed weekend environments. We believe that our consumers are seeking a refined level of product quality and distinctiveness, and our designs, manufacturing standards and marketing are structured accordingly.

**INFORMATION SYSTEMS.** We employ a fully integrated, real-time management information system that is specifically designed for our industry. The system includes important features such as manufacturing resource requirements planning, production scheduling, detailed product tracking, standard cost system planning and control, and detailed perpetual inventory systems. As our production personnel track original purchases through various factory production phases, our merchandisers track sales in order to compare purchases against availability, thereby allowing us to react quickly to changes and trends. Our product development team utilizes sophisticated computer-aided design software to meet our customers' design, collaboration and specification requirements. We also have a remote-order entry system for our sales force, allowing them to monitor and establish sales plans and communicate order specifics. Customer service personnel receive this uploaded information daily and have real-time access to inventory availability.

This comprehensive information system serves users in each of our operating areas, and is also used to create costing models, specification sheets and production scheduling. The manufacturing module integrates with the general ledger accounting and financial module. Our information system also provides detailed product gross margin information that assists us in managing product profitability. During fiscal 2004, we continued to expand the relational database capabilities of our management information system to allow us to create specialized management reports and access critical decision support data.

**COMPETITION.** The promotional products and imprinted sportswear industry is highly competitive. Dun and Bradstreet estimates that there are over 19,000 promotional product companies in North America. According to Promotional Products Association International, the top 40 companies' sales represented \$3.2 billion or less than one-fifth of the industry's total sales of \$16.3 billion in 2003, which is the most current data available. Our primary distribution channels are highly fragmented with substantial competition from other distributors of promotional products. We believe that our ability to compete effectively is based primarily on product differentiation, product quality, production flexibility and distribution capabilities, all of which Management believes enhance the Company's brands.

**CUSTOMER BASE.** During the past three years, the Company has made a concerted effort to expand its customer base. As a result of this effort, the Company has developed a large, diverse, and distinguished customer base of traditional retailers, ranging from national as well as large regional chains to specialty retailers, corporate accounts, college book stores, motor sports, souvenir and gift shops, and golf shops. The Company believes that its customer diversification and expansion program will be evident in fiscal year 2005 and beyond. The following represent a cross section of the Company's larger customers segregated by distribution channel:

**National Retail Merchants:** Goody's, Kohl's, Sears, K-Mart, Dillard's, J.C. Penney, Belk, Bon-Ton, Federated Dept Stores



|  |  |
|--|--|
| <b>Specialty Retailers:</b>                        | Dollar General, Sam's Wholesale Club, Value City   |
| <b>Sporting Goods Chains:</b>                      | Sports Fan, MC Sports, Gator Sports, Delaware North Companies, Academy, Football Fanatics, Scheels Sports      |
| <b>Corporate Accounts and College Book Stores:</b> | Nebraska Book Company, Barnes & Noble, Jawhawk Spirit, Husker Hounds, Love's Country Stores                    |
| <b>Food &amp; Drug Chains:</b>                     | Kroger's, Mini Mart, Stay Mart   |
| <b>Motor Sports:</b>                               | Dodge, Pontiac, Chevy, GMC, Ford, Chrysler, Plymouth, Jeep dealer networks, and Motorcycle Dealers, Gift Shops |
| <b>E-Commerce:</b>                                 | General public via website distribution  |

**GROWTH STRATEGY.** The industries in which the Company competes are highly fragmented with no single company or group of companies holding a dominant market share. As a result, Management believes that there are significant growth opportunities available to the Company that include the following:

**Expansion of the Company's Licensed Imprinted Sportswear Business.** In recent years, licensed imprinted sportswear has become very popular. Licensing agreements are available for branded products and services, amateur and professional sports teams, and many other promotional areas. According to statistics from the International Licensing Industry Merchandisers' Association, licensing revenue from collegiate licensed products increased 11.5% from 2002 to 2003. Similarly, licensing revenue from sports licensed products increased 5.7% over the same period. These two types of licenses make up a large percentage of the Company's sales base. The Company is constantly working to expand its licensing program to take gain an advantage in the competitive licensed imprint sportswear business.

**E-Commerce.** The Company has expanded its business to include e-commerce web sites through which some of the Company's most popular licensed products are marketed. The Company has been successful in establishing itself as a premier supplier under various e-commerce web sites, currently the most significant of which are [www.campustraditionsusa.com](http://www.campustraditionsusa.com),<sup>TM</sup> [www.rpmsportswearusa.com](http://www.rpmsportswearusa.com),<sup>TM</sup> and [www.americanbiker.net](http://www.americanbiker.net),<sup>TM</sup> [www.americanwildlifeusa.com](http://www.americanwildlifeusa.com).<sup>TM</sup> Another recent addition includes a corporate website, [www.nextinc.net](http://www.nextinc.net), which gives information to the general public about the Company.

**Increased Marketing of the Company's Proprietary Designs.** The Company has developed several proprietary designs that Management believes will increase its penetration into existing customer base and broaden its product offering to new accounts. The proprietary designs cover a broad spectrum of themes such as: **American Wildlife**<sup>®</sup> (outdoor activities), **American Biker**<sup>®</sup> (motorcycles), **Cadre Athletic**<sup>®</sup> and **Campus Traditions USA**<sup>TM</sup> (college and athletics), among others.

**Strategic Mergers and Acquisitions.** In addition to organic growth, the Company also plans to grow through selective strategic mergers and acquisitions. Management believes that there are a number of quality merger candidates that will enable the Company to expand and diversify its presence in the marketplace. The Company's key acquisition criteria include: proven historical success, diverse customer base, and companies that possess a reputation

for quality in the marketplace.

**INDUSTRY.** The Company operates in two interrelated industries – the promotional products industry and the imprinted sportswear industry:

**Promotional Products Industry.** The promotional products industry is highly fragmented consisting mainly of smaller privately held companies with no dominant positions. It is also a niche industry that is comprised of thousands of companies that distribute products bearing designs, logos, names, or catchy phrases. Examples of the products distributed by the companies in the industry include: imprinted sportswear, key chains, coffee mugs, pens, golf balls, mouse pads, clocks, etc. It is estimated that 30% or just over \$5 billion of all promotional products sold are imprinted sportswear (wearables) products, making imprinted sportswear, by far, the number one selling product of all promotional products sold.

According to Promotional Products Association International ( PPAI ), a trade organization for the promotional products industry, the industry has experienced exceptional growth over the last ten years growing in sales from \$6.2 billion in 1993 to \$16.3 billion in 2003, which is the most current data available. Dun and Bradstreet estimates that there are over 19,000 promotional product companies in North America.

**Imprinted Sportswear Industry.** The imprinted sportswear industry is also a niche industry that entails value added embellishment (embroidering or screen-printing) of products. The items that are imprinted include: headwear, polo shirts, long-sleeve shirts, fleece wear, shorts, jackets, beach towels, souvenir blankets and t-shirts. The imprinted sportswear is sold primarily through traditional and specialty retailers ranging from large national and regional chains to sporting goods stores, casinos, golf and tennis pro shops, souvenir shops and sports stadiums.

**Trends.** A significant industry trend is the evolving requirement of customers to have suppliers provide enhanced value-added services to them. A primary attribute that customers are seeking is a company's ability to be a one-stop shop for all products requirements. In effect, customers are now looking to their suppliers to provide enhanced value-added services: design and graphic capabilities, fulfillment and warehousing, company store planning and execution and on-line purchasing. The corporate sales market is comprised primarily of corporations that purchase imprinted sportswear bearing the corporation's logo, name, or a theme.

**SUPPLIERS.** The Company sources a significant portion of its products with international suppliers. The majority of the products used by the Company are available from multiple sources. Alternative suppliers are currently available to the Company both domestically and internationally. In 2004, key suppliers included DZ Trading, Inc. and Choice Apparel, Inc.

**EMPLOYEES.** As of January 29, 2005, the Company had one hundred thirty one employees. We consider our relations with our employees to be satisfactory.

**ACQUISITIONS AND REFINANCING.** Pursuant to the terms of an Asset Purchase Agreement (the Agreement ), dated October 31, 2004 by and among Choice Acquisition Corporation (a wholly owned subsidiary of the Company), Choice International, Inc. ( Choice ), Mark Scyphers and William Steele, the Company, through a subsidiary, acquired all of the assets of Choice and the right to sell all items previously sold by the principals. Choice s customers, distribution networks, and purchasing channels, diversify, complement, and bolster the Company s existing customer and distribution base. The Company expects that future sales and earnings will continue to show strong growth. The Company, during fiscal 2004, fully integrated the operations of Choice into the operating facility located in Wabash, Indiana (see NOTE 14 of the Notes to Consolidated Financial Statements contained elsewhere in this document).

On January 20, 2004, the Company entered into subordinated loan agreements with Next Investors, LLC for \$400,000 and First Federal Savings Bank for \$500,000. The purpose of these loans was to provide working capital to be repaid out of a future equity infusion. The loans have a 4% and 6% interest rates and maturity dates of January 20, 2006 and 2005, respectively. In April of 2004 the First Federal note of \$500,000 was paid off out of the proceeds of the equity infusion by GCA Strategic Investment Fund Limited, described below.

On April 8, 2004, the Company issued, pursuant to a Securities Purchase Agreement 1,750 shares of Series A Convertible Preferred Stock to GCA Strategic Investment Fund Limited. The Company received net proceeds of \$1,471,498, from the Preferred Stock which was utilized for working capital and debt reduction. The Company has registered these shares but will not receive proceeds related to the sale of the common stock securities. The Company also issued a Preferred Stock Warrant to GCA to purchase 358,000 shares of common stock at \$1.88, which expires April 8, 2009. The Company also received a commitment letter from Global Capital Advisors, LLC for an additional \$1,250,000 under the same terms and conditions discussed above at the Company s option for a one year period which will expire on March 31, 2005. The Company has no plans to exercise this additional commitment.

On April 15, 2004, the Company entered into a credit agreement with National City Bank for an \$8,000,000 revolving credit facility agreement which matures on April 1, 2006. Under the National City agreement the Company may draw up to the sum of 85% of eligible accounts receivable, as defined, and 60% of eligible raw materials and finished goods inventory. In addition, the agreement provides for monthly payments of interest at a nationally published prime rate plus .25% (5.00% was the published rate at November 30, 2004) and the Company must comply with certain financial and other covenants. Accounts receivable, inventory, certain personal assets and personal guarantees of the Company s CEO and CFO collateralize the borrowings under the facility. The credit agreement with National City replaces the former lender, LaSalle Business Credit, LLC and increases the Company s borrowing base formula, reduces expenses, and extends the maturity date by one year.

On July 23, 2004, the Company entered into a new loan with First Federal Saving Bank for certain production equipment in the amount of \$276,500 bearing interest at 6.5%. Principal and interest payments are made monthly and the loan matures November 2, 2009.

On January 24, 2005, the Company entered into a Securities Purchase Agreement (the Agreement) with Bonanza Master Fund, Ltd. ( Bonanza ), MidSouth Investor Fund, L.P. ( MidSouth ) and Itasca Capital Partners LLC ( Itasca ) (collectively, the Purchasers) and raised \$2,990,000 in a private placement to the Purchasers. None of the Purchasers has any other material relationship with the Company. Pursuant to the Agreement, Next issued to Bonanza, 2,000,000 shares of its common stock and a warrant to purchase 1,000,000 shares, to MidSouth, 250,000 shares and a warrant to purchase 125,000 shares, and to Itasca, 50,000 shares and a warrant to purchase 25,000 shares. The shares were issued at \$1.30 per share and the warrants are exercisable at \$1.75 per share for five years. In addition, the Company will issue a warrant to purchase 115,000 shares of common stock to a consultant for its services in connection with the private placement. The warrants are exercisable at \$1.75 per share for five years, but the average closing price must be equal to at least \$2.10 for ten consecutive trading days to exercise purchase. The total offering price was \$2,990,000 in cash.

**Future Acquisitions.** The Company is actively engaged in discussions with various potential acquisition targets and expects to grow through strategic acquisitions of complimentary businesses. Management believes that additional acquisitions by the Company will allow it to further diversify its customer and distribution base, lessen its current dependence on large customers, and enhance stockholder value. Although Management believes that these acquisitions will be completed in the near future, the Company is not presently a party to any definitive agreements with respect to any acquisitions and there can be no assurances that any acquisition will be accomplished in the near future or at all.

**Business Developments in 2004.** On April 15, 2004, the Company announced a licensing agreement with James Dean, Inc. whereby Next will utilize the name, image and trademarks of James Dean in an exciting, new branded apparel offering. From commemorative programs and recognition events coordinated through city officials, to historic preservation efforts, to co-branding programs with James Dean and some of the most prestigious brands in the world, the 50<sup>th</sup> Anniversary Celebration of the death of this cultural icon promises to be a major media and publicity event.

On July 20, 2004, the Company announced a licensing agreement with Professional Bull Riders (PBR). PBR's licensed products are among the top selling licensed products at western retailers nationwide. The Company believes the consistency in demographics between PBR fans and the Company's licensed automotive apparel line and our American Wildlife line will present great cross-selling opportunities.

On September 28, 2004, the Company announced a licensing agreement with DaimlerChrysler Corp. The Company believes this rapidly growing product line will assist us in achieving our goal to minimize the seasonal aspect of the business, as automotive licensed products are less seasonal than collegiate licensed items. Additionally, in October, 2004, the Company obtained a signed licensing agreement with C3 Entertainment, Inc. for The Three Stooges®. This license could provide the Company with more opportunities for non-seasonal sales and growth.

On October 21, 2004, the Collegiate Licensing Company ( CLC ) ranked the Company number fifteen of its collegiate sports wearable providers along with major distributors such as Nike USA and Champion®. CLC is the nation's leading collegiate licensing and marketing representative in the nation.

On December 28, 2004, the Company announced a licensing agreement with The Fellowship of Christian Athletes (FCA). FCA just celebrated its 50th year in existence and their supporters are extremely loyal and growing dramatically in number.

## **RISK FACTORS**

**Risks Related To Our Business.** In addition to the other information contained in this report, including risks and uncertainties described elsewhere, the following risk factors should be considered in evaluating the Company. The risks and uncertainties described below or elsewhere in this report are not the only ones the Company faces. Additional risks and uncertainties not presently known to the Company or that the Company currently deems immaterial also may impair the Company's business and operations. If any of the risks described below or elsewhere in this report materialize, the Company's business, financial condition, operating results and cash flows could be materially affected. Stockholders or investors considering the purchase of shares of the Company's common stock should carefully consider the following risk factors, in addition to the other information contained in this report.

You should not rely on the Company's past results to predict its future performance because its operating results fluctuate due to factors which are difficult to forecast and often out of the Company's control. The Company's past revenues and other operating results may not be accurate indicators of the Company's future performance. The factors that may contribute to these fluctuations include: fluctuations in aggregate capital spending, cyclicity and other economic conditions in one or more markets in which we sell our products; changes or reductions in demand in the markets we serve; a change in market acceptance of the Company's products or a shift in demand for the Company's products; new product introductions by the Company or by the Company's competitors; changes in product mix and pricing by the Company, its suppliers or its competitors; pricing and related availability of raw materials for the Company's products; the Company's failure to manufacture a sufficient volume of products in a timely and cost-effective manner; the Company's failure to anticipate changing product requirements of its customers; changes in the mix of sales by distribution channels; exchange rate fluctuations; and extraordinary events such as litigation or acquisitions.

**Loss of Licenses.** A substantial portion of the Company's revenue is derived from its licensing program and Company owned brands. The Company is a party to numerous licensing agreements to utilize branded logos for its products. Licenses from colleges and universities comprise the greatest segment of the Company's licenses and these licenses are grouped into master licenses. All of these master license arrangements have a duration of one to three years and may not contain automatic renewal options. Although the Company has had no difficulty renewing these license arrangements in the past and obtaining new licenses, there can be no assurance that the Company will be able to do so in the future. The loss of any one group of licenses or any master license may have a material adverse effect on the Company's financial conditions and results of operations.

**Competition.** The principal competitive factors affecting the market for the Company's products include product functionality, performance, quality, reliability, delivery, price, compatibility and conformance with customer and licensor standards. Several of the Company's existing and potential competitors are larger than the Company and may have substantially greater financial, sourcing and other resources than does the Company. In addition, the Company may in the future face competition from new entrants in its markets and there can be no assurance that these competitors will not offer better price points for competitive products or offer better terms to the Company's customers than those offered by the Company to obtain greater market share or cause the Company to lower prices for its products, any of which could harm the Company's business.

**Dependence Upon Key Personnel.** The Company depends to a significant degree on the continued contribution of key executive management and key operations and sales management. The loss of the services of one or more key executives could have a material adverse effect on the Company. The Company's success also depends on its ability to attract and retain additional highly qualified management personnel to meet the needs of future expansion. Competition for these individuals is intense and they are often subject to offers from competing employers, some of whom may be better able to offer more lucrative compensation incentives than those offered by the Company. Although most of the Company's key employees have been with the Company for an extended period of time, there can be no assurance that the Company will be able to retain its key employees, or that it will be able to attract or retain additional skilled personnel as needed. The Company's key executive management, senior operational, finance and sales management personnel have entered into written employment contracts with the Company.

**Dependence On Non-U.S. Suppliers.** The Company sources a significant amount of its products from international suppliers. Relationships with foreign suppliers present a greater risk of disruption due to political and economic instability than relationships with domestic suppliers. Although the majority of the products used by the Company are available from multiple sources both domestically and internationally, any disruption in availability of products and services from these foreign suppliers could lead to increases in the Company's product costs. The Company believes it can locate alternative products from several supplier sources to obtain the quality, cost and delivery standards if a disruption in international sources should occur.

**Dependence Upon Key Customers.** Historically, the Company's customer base has been comprised primarily of national and regional mass merchandise and specialty retailers. During the past three years the Company has made a concerted effort to expand its customer base. The acquisition of CMJ Ventures, Inc. ( CMJ ), which sells to over five hundred specialty retailers, and the introduction of major product lines and distribution channels, such as its Motor Sports Division, which sells to a dealer network of approximately 9,000 auto dealers are two components of this expansion. The acquisition of Lil Fan, Inc ( Lil Fan ) also expanded the Company's customer base with the addition of a full line of design and merchandising primarily focusing on children's licensed college and motor sports products. Lil Fan customers are complementary to the Company and do not overlap with existing customers. The acquisition of Choice International, Inc further expands the customer base into a private label distribution network. As a result of this effort, the Company has developed a large, diverse, and distinguished customer base of traditional retailers, ranging from national and large regional chains to specialty retailers, corporate accounts, college book stores, motor sports, souvenir, golf and gift shops. If the Company is unable to sustain this expansion of its customer base or if it is unable to maintain its customer base it could have a negative impact on its financial condition and results of operations.

**Possible Need For Additional Financing/Capital.** The Company is highly leveraged. Based upon the Company's current level of operations and anticipated growth, the Company believes that cash flows from operations, together with its working capital facility, will be sufficient to enable the Company to satisfy anticipated cash flow requirements for operating, investment and financing activities, including debt service. However, with the Company's expected expansion and additional acquisitions, the Company could be required to obtain additional financing and/or capital, by private placement or in the public markets, to satisfy its requirements. There can be no assurance that such alternatives would be available to the Company at all or on terms reasonably acceptable to the board of directors. If we cannot obtain adequate funds on acceptable terms or at all, we may not be able to take advantage of market opportunities, develop or enhance new products, pursue acquisitions that would complement our existing product offerings, execute our business plan or otherwise respond to competitive pressures or unanticipated requirements.

**Limited Trading Market For Common Stock.** The Company's common stock is quoted on the National Association of Securities Dealers' OTC Bulletin Board. There may be a limited trading market for the common stock.

**Volatility Of Common Stock's Market Price.** The market price of the common stock is more volatile than the price of common stock of more established companies, because of the limited number of shareholders and the low volume of trading. In addition, the price is subject to a variety of factors, including the business environment; the operating results of companies in the industries we serve; future announcements concerning the Company's business or that of its competitors or customers; the introduction of new products or changes in product pricing policies by the Company or its competitors; litigation matters; changes in analysts' earnings statements; developments in the financial markets; quarterly operating results; and perceived dilution from stock issuances for acquisitions and other transactions. Furthermore, stock prices for many companies fluctuate for reasons that may be unrelated to their operating results. Those fluctuations and general economic, political and market conditions, such as recessions, terrorist actions or other military actions, or international currency fluctuations, as well as public perception of equity values of publicly traded companies may adversely affect the market price of our common stock.

**Additional Shares.** The Board of Directors has the authority to issue, without further action by the stockholders, up to 9,998,250 additional shares of preferred stock in one or more series and to fix the price, rights, preferences, privileges and restrictions thereof, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences and the number of shares constituting a series or the designation of such series. The Company has already issued 1,750 shares of Series A Preferred Stock, of which 204 shares remain outstanding. The issuance of preferred stock, while providing desirable flexibility in connection with possible acquisitions and other corporate purposes, could have the effect of delaying, deferring or preventing a change in control of the Company without further action by the stockholders and may adversely affect the market price of, and the voting and other rights of, the holders of common stock.

## ITEM 2.

### DESCRIPTION OF PROPERTY

The Company's executive office is located in leased office space in Chattanooga, Tennessee, under a lease for approximately 2,000 square feet that expires in 2007. The Company also leases approximately 3,000 square feet sales office in Noblesville, Indiana, under a lease, which expires in 2006, and an approximately 1,500 square feet sales office in Lexington, SC, under a lease that expires in 2007. The total lease cost for all three facilities is \$5,350 per month. The Company rents warehouse space in Wabash, Indiana that is not subject to a lease agreement which amounted to \$93,000 in 2004. The Company owns, subject to a mortgage, its principal manufacturing, distribution, administrative and design facility located in Wabash, Indiana (the Operating Facility). The Operating Facility is approximately 125,000 square feet and is in excellent condition. Management believes that its existing owned and leased facilities are adequate to meet the Company's needs for the foreseeable future.

**ITEM 3.**

**LEGAL PROCEEDINGS**

The Company has pending various minor legal actions arising in the normal course of business. Management does not believe that such legal actions, individually or in the aggregate, will have a material impact on the Company's business, financial condition or operating results.

**ITEM 4.**

**SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Company held its annual stockholder meeting on October 26, 2004. At the annual meeting, the stockholders voted upon the election of four directors, the ratification of the appointment of the Company's independent auditors, Tauber & Balser, P.C, authorization to reserve 1,000,000 shares of common stock to the Company Stock Option Plan, and a proposal to adopt the Amended and Restated bylaws of Next, Inc. The votes were cast as follows:

| <b>Directors</b>                            | <b><u>For</u></b> | <b><u>Against</u></b> | <b><u>Withheld</u></b> | <b><u>Abstentions</u></b> |
|---|-------------------|-----------------------|------------------------|---------------------------|
| Ronald J. Metz                              | 15,560,211        | 0                     | 55,608                 | 0                         |
| G. Michael Cross                            | 15,560,211        | 0                     | 55,608                 | 0                         |
| Salvatore Geraci                            | 15,560,211        | 0                     | 55,608                 | 0                         |
| William B. Hensley III                      | 15,560,211        | 0                     | 55,608                 | 0                         |
| <b>Ratification of Independent Auditors</b> | <b><u>For</u></b> | <b><u>Against</u></b> | <b><u>Withheld</u></b> | <b><u>Abstentions</u></b> |
| Tauber & Balser, P.C.                       | 15,186,841        | 34,570                | 0                      | 404,408                   |



|   |                   |                       |                        |                           |                                    |
|---|-------------------|-----------------------|------------------------|---------------------------|------------------------------------|
| <b>Adopt Amended and Restated<br/>Bylaws of Next, Inc.</b>  | <b><u>For</u></b> | <b><u>Against</u></b> | <b><u>Withheld</u></b> | <b><u>Abstentions</u></b> |                                    |
|   | 15,564,087        | 61,694                | 0                      | 38                        |                                    |
| <b>Authorize Reservation of 1,000,000 common<br/>shares</b> | <b><u>For</u></b> | <b><u>Against</u></b> | <b><u>Withheld</u></b> | <b><u>Abstentions</u></b> | <b><u>Broker<br/>Non-Votes</u></b> |
| <b>Next, Inc. Stock Option Plan</b>                         | 10,285,378        | 621,948               | 0                      | 768                       | 4,338,997                          |

**PART II****ITEM 5.****MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

The following table sets forth the high and low closing prices of the Company's common stock for the periods indicated, as reported by published sources. The prices reflect inter-dealer prices, without retail mark-up, markdown or commission and may not represent actual transactions.

|  | <b><u>Low</u></b> | <b><u>High</u></b> |
|--|-------------------|--------------------|
| <b><u>2005 Fiscal Year</u></b>           | \$                | \$                 |
| First Quarter (through February 8, 2005) | 1.40              | 1.67               |
| <b><u>2004 Fiscal Year</u></b>           | \$                | \$                 |
| First Quarter                            | 1.02              | 1.55               |
|  | \$                | \$                 |
| Second Quarter                           | 1.20              | 1.90               |
|  | \$                | \$                 |
| Third Quarter                            | 1.23              | 1.60               |
|  | \$                | \$                 |
| Fourth Quarter                           | 1.30              | 1.68               |
| <b><u>2003 Fiscal Year</u></b>           | \$                | \$                 |
| First Quarter                            | 0.11              | 0.75               |
|  | \$                | \$                 |
| Second Quarter                           | 0.12              | 0.55               |
| Third Quarter                            | \$                | \$                 |

|                |      |      |
|----------------|------|------|
|                | 0.48 | 1.26 |
|                | \$   | \$   |
| Fourth Quarter | 0.71 | 1.82 |

As of February 10, 2005, there were approximately 1,432 holders of record of our common stock.

The Company has never declared a cash dividend on its common stock and its Board of Directors does not anticipate that the Company will pay cash dividends in the foreseeable future. The Company has a covenant in the loan agreement with its primary lender that stipulates it cannot pay dividends on common stock. However, the Company is required to pay a 2% dividend on all Preferred stock outstanding; in 2004 \$13,396 was paid in additional shares of common stock, and \$2,319 was paid in cash.

On October 31, 2004, the Company issued 100,000 shares of common stock, with up to an additional 450,000 shares to be issued on a deferred basis pursuant to an earn-out and \$200,000 in cash as consideration for the assets of Choice International, Inc. The shares were issued to the shareholders of Choice International, Inc. in a transaction exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. The transaction was negotiated with the shareholders, who were a small group of sophisticated investors knowledgeable about the Company.

## ITEM 6.

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

You should read this section together with our consolidated financial statements and related notes thereto included elsewhere in this report. In addition to the historical information contained herein, this report contains forward-looking statements that are subject to risks and uncertainties. Forward-looking statements are not based on historical information but relate to future operations, strategies, financial results or other developments. Forward-looking statements are necessarily based upon estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and many of which, with respect to future business decisions, are subject to change. Certain statements contained in this Form 10-KSB, including, without limitation, statements containing the words believe, anticipate, estimate, expect, are of the opinion that and words of similar import, constitute forward-looking statements. You should not place any undue reliance on these forward-looking statements.

You should be aware that our actual growth and results could differ materially from those contained in the forward-looking statements due to a number of factors, which include, but are not limited to the following: the special risk factors set forth in Part I, Item 1 Risk Factors above, the risks and uncertainties set forth below; economic and

business conditions specific to the promotional products and imprinted sportswear industry; competition and the pricing and mix of products offered by us and our competitors; style changes and product acceptance; relations with and performance of suppliers; our ability to control costs and expenses, carry out successful designs and effectively communicate with our customers and to penetrate their chosen distribution channels; access to capital; foreign currency risks; risks associated with our entry into new markets or distribution channels; risks related to the timely performance of third parties, such as shipping companies, including risks of strikes or labor disputes involving these third parties; maintaining satisfactory relationships with our banking partners; political and trade relations; the overall level of consumer spending; global economic conditions and additional threatened terrorist attacks and responses thereto, including war. There may be other factors not mentioned above or included elsewhere in this report that may cause actual results to differ materially from any forward-looking information. You should not place undue reliance on these forward-looking statements. We assume no obligation to update any forward-looking statements as a result of new information, future events or developments, except as required by applicable securities laws.

**INTRODUCTION.** As noted elsewhere in this report, the Company's principal customers are large national and regional retailers. In order to maintain its relationship with these customers, enhance revenues from them and enable them to improve their revenues and margins, the Company must work closely with these customers to ensure they receive the Company's products expeditiously and economically. The Company works diligently to maintain what Management calls "supply chain excellence" a way for the Company to provide value added services to its customers.

In servicing its customers, the Company faces competition from numerous other providers of licensed promotional clothing. Many of these competitors are larger and better capitalized than the Company. Additionally, if the Company is to continue to grow its business by adding additional products and by making strategic acquisitions, it will require additional capital. Therefore, Management is currently negotiating with several sources of equity in an effort to furnish the needed capital.

In assessing the Company's performance, Management focuses on (a) increasing revenues primarily through enhancing its licensing programs and (b) protecting such revenues by diversifying its customer bases regionally and demographically. In order to enhance profitability, Management monitors and seeks to improve gross margins primarily by internal cost controls and through purchases of raw materials outside the United States at lower costs than available domestically. Management also strives to reduce fixed costs as a percentage of sales, improve inventory turnover and reduce receivables measured by days sales outstanding, all in an effort to improve profitability and cash flow.

**RESULTS OF OPERATIONS.** The following table sets forth certain items in the Company's consolidated statement of operations for the years ended November 30, 2003, and 2004, respectively. The results of operations for 2004 include the revenues of Choice International of \$103,296 from October 31, 2004, the date of its acquisition. Choice International was a newly formed corporation and had no previous operating results (see NOTE 14 of the Notes to Consolidated Financial Statements contained elsewhere in this report). These statements should be read in conjunction with the audited financial statements of the Company contained elsewhere in this Form 10-KSB.

|   | <b><u>November 30,</u></b> |                    |
|---|----------------------------|--------------------|
|   | <b><u>2003</u></b>         | <b><u>2004</u></b> |
|   | \$                         |                    |
| Net sales                               | 20,873,989                 | \$ 21,518,753      |
| Cost of sales                           | 14,461,801                 | 14,892,346         |
| Gross profit                            | 6,412,188                  | 6,626,407          |
| Operating and other expenses:           |                            |                    |
| General and administrative expense      | 2,210,045                  | 2,241,108          |
| Royalty and commission expense          | 2,211,593                  | 2,680,462          |
| Corporate expense                       | 1,062,764                  | 1,026,774          |
| Interest expense                        | 455,839                    | 493,588            |
| Other expense                           | 10,764                     | 601,350            |
| Total operating and other expense       | 5,951,005                  | 7,043,282          |
| Income (loss) before income taxes       | 461,183                    | (416,875)          |
| Provision for (benefit of) income taxes | 182,356                    | (136,085)          |
|   | \$                         |                    |
| Net income (loss)                       | 278,827                    | \$ (280,790)       |

**NET SALES.**

Net sales increased 3.1% to \$21,518,753 for 2004 from \$20,873,989 for 2003. The growth in sales is primarily attributable to increased sales volume from existing customers and new customers resulting in a net increase of \$644,764. Choice International customers from the date of acquisition generated an additional \$103,296 of sales in 2004.

**COST OF SALES.** Cost of sales was \$14,892,346 or 69.2% of the Company's net sales for 2004 compared to \$14,461,801 or 69.2% for 2003.

**OPERATING AND OTHER EXPENSES.** General and administrative expenses were \$2,241,108 (10.4% of net sales) for 2004 compared to \$2,210,045 (10.6% of net sales) for 2003. General and administrative expenses increased by \$31,063 or 1.4%, which was primarily related to cost added as a result of the Lil Fan and Choice International operating entities.

Royalty fees associated with licensing agreements was \$1,614,481 or 7.5% of sales in 2004 and \$1,232,936 or 5.9% of sales in 2003. The increase in fees is the result of a higher percentage of our sales that are licensed products, which is the Company's primary sales and marketing focus. Commission expenses were \$1,065,981 or 5.0% of sales in 2004, and \$978,657 or 4.7% in 2003, which increased primarily due to more external sales personnel, who are commission based.

Corporate expense consists of full-time personnel, legal services, accounting fees, and investment professionals. While these services have resulted in significant costs during the current period, the Company believes that such costs are necessary for the Company to implement its strategic plan of future growth and diversification. Fiscal year 2004 expenses were \$1,026,774, however expenses for 2003 were \$1,062,764, for a decrease of \$35,990 or 3.4%.

Interest expense relates to the Company's short and long-term debt. Interest expense was \$493,588 for 2004, compared to \$455,839 for 2003. The primary reasons for the increase in interest expense were the higher interest rate on the average borrowings of the revolving credit facility and a higher average debt balance for the year.

Other expenses include an unusual one-time write off of \$640,000, offset by \$38,650 of other income. The components of the unusual item relate to \$501,000 of fees and expenses associated with the Company's former bank, LaSalle Business Credit, LLC that was terminated on April 15, 2004. It also includes \$139,000 of one-time legal fees related to a complaint filed against the former Chairman and CEO in the Southern District of New York that was dismissed on May 10, 2004.

**PROVISION FOR INCOME TAXES.** The Company recognized a tax benefit of \$136,085 in 2004 which is attributable to the recognition of deferred tax assets arising from the Company's year-to-date net operating loss adjusted by book and income tax recognition temporary differences. In 2003 the Company recognized a tax provision of \$182,356.

**FINANCIAL POSITION, CAPITAL RESOURCES, AND LIQUIDITY.** At November 30, 2004, working capital was \$9,600,679, representing an increase of \$2,974,684 from working capital at November 30, 2003, of \$6,625,995. This increase in working capital was primarily due to the increase in receivables related to fourth quarter sales, and inventory expansion due to the increase in product lines.

**Liquidity and Capital Resources.** The Company has historically financed its operations through a combination of earnings and debt. The Company's principal sources of debt financing are its revolving line of credit with National City Bank and promissory notes issued by First Federal Savings Bank. On April 15, 2004, the Company renegotiated its working capital facility with National City Bank to replace LaSalle Business Credit with an \$8,000,000 credit facility. The Company reduced its interest, fees, and extended the term to April 1, 2006. At November 30, 2004, \$6,907,787 of the credit facility had been drawn upon. The Company amended the credit facility on October 20, 2004 for 90 days to increase the line to \$9,000,000 due to higher fourth quarter sales. The amendment was voluntarily terminated on December 7, 2004. The National City credit facility is governed by various financial covenants, all of which are in compliance as of the date of this report. In addition the agreement provides for monthly payment of interest of .25% over a nationally published prime rate (5% at November 30, 2004). The First Federal Savings Bank Promissory Notes consist of one principal loan in the amount of \$2,800,000 payable in monthly installments of \$26,000 of principal and interest with a balloon payment of \$2,647,805 due January 16, 2006.

On January 20, 2004 the Company entered into subordinated loan agreements with Next Investors, LLC for \$400,000 and First Federal Savings Bank for \$500,000. The purpose of these loans was to provide working capital to be re-paid out of future equity transactions. The loans have a 4% and 6% interest rate and maturity dates of January 2006 and 2005 respectively. On April 8, 2004 the note to First Federal was paid from proceeds of the equity infusion from GCA Strategic Investment Fund.

On April 8, 2004, the Company issued, pursuant to a Securities Purchase Agreement 1,750 shares of Series A Convertible Preferred Stock to GCA Strategic Investment Fund Limited. The Company received net proceeds of \$1,471,498, from the Preferred Stock which was utilized for working capital and debt reduction. The Company has registered these shares but will not receive proceeds related to the sale of the common stock securities. The Company also issued a Preferred Stock Warrant to purchase 358,000 shares of common stock at \$1.88, which expires April 8, 2009. The Company also received a commitment letter from Global Capital Advisors, LLC for an additional \$1,250,000 under the same terms and conditions discussed above at the Company's option for a one year period which will expire on March 31, 2005. The Company has no plans to exercise this additional commitment.

On July 19, 2004 the Company entered into a note with First Federal for certain production equipment in the amount of \$276,500 with an interest rate of 6.5% which matures November 2, 2009. The monthly principal and interest payment is \$5,421.

Subsequent to the Company's fiscal year end, on January 24, 2005, the Company entered into a Securities Purchase Agreement (the "Agreement") with Bonanza Master Fund, Ltd. ("Bonanza"), MidSouth Investor Fund, L.P. ("MidSouth") and Itasca Capital Partners LLC ("Itasca") (collectively, the "Purchasers") and raised \$2,990,000 in a private placement to the Purchasers. None of the Purchasers has any other material relationship with the Company. Pursuant to the Agreement, Next issued to Bonanza, 2,000,000 shares of its common stock and a warrant to purchase 1,000,000 shares, to MidSouth, 250,000 shares and a warrant to purchase 125,000 shares, and to Itasca, 50,000 shares and a warrant to purchase 25,000 shares. The shares were issued at \$1.30 per share and the warrants are exercisable at \$1.75 per share for five years. In addition, the Company will issue a warrant to purchase 115,000 shares of common stock to a consultant for its services in connection with the private placement. The warrants are exercisable at \$1.75 per share for five years, but the average closing price must be equal to at least \$2.10 for ten consecutive trading days to exercise purchase. The total offering price was \$2,990,000 in cash.

Seasonality of sales affects the company's liquidity and profitability as the majority of sales are booked in the third and fourth quarters of the fiscal year. In 2004 and 2003 approximately 64.1% and 57.7% respectively, represent the combined third and fourth quarter sales as a percentage of total sales. This trend is in large part is due to the college licensed products lines which are sold to major retail customers that occur in these periods.

The Company's principal use of cash is for operating expenses, interest and principal payments on its long-term debt, working capital and capital expenditures. Cash used in operations for 2004 was \$2,644,114 as compared to \$1,005,294 for 2003. The increase in cash used resulted primarily from increased working capital utilization and losses from operations.

Cash used for investing activities was \$762,170 for 2004, compared to \$879,651 for 2003. The Company's investing activities during these periods was primarily the purchase of new equipment, acquisition cost, and expenses related to intangible assets.

Net cash provided by financing activities was \$3,122,070 for 2004, compared to \$2,027,035 for 2003. The increase of \$1,095,035 was primarily related to proceeds from issuance of preferred stock for cash, net of cash paid for the investment transaction.

The following table represents the contractual commitments of the Company as of November 30, 2004:

| <u>Contractual Obligations</u>     | <u>Total</u> | <u>Payments Due by Period</u> |                    |                    |                      |
|------------------------------------|--------------|-------------------------------|--------------------|--------------------|----------------------|
|                                    |              | <u>Less than 1 year</u>       | <u>1 - 3 years</u> | <u>4 - 5 years</u> | <u>After 5 years</u> |
|                                    | \$           |                               |                    |                    |                      |
| Revolving Credit Facility          | 6,907,787    | \$                            | \$ 6,907,787       | \$                 | \$                   |
| Long-Term Debt                     | 3,704,510    | 235,236                       | 3,248,096          | 109,483            | 111,695              |
| Capital Lease Obligations          | 22,403       | 17,535                        | 4,868              |                    |                      |
| Operating Leases                   | 161,900      | 64,200                        | 95,900             | 1,800              |                      |
|                                    | \$           |                               |                    |                    |                      |
| Total Contractual Cash Obligations | 10,796,600   | \$ 316,971                    | \$ 10,256,651      | \$ 111,283         | \$ 111,695           |

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES, AND NEW PRONOUNCEMENTS.** Our significant accounting policies are described in NOTE 2 - Basis of Presentation and Summary of Significant Accounting Policies of the Notes to our financial statements. Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of the financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate the estimates that we have made. These estimates have been based upon historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

**Allowance for Doubtful Accounts and Returns.** The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments, which is included in bad debt expense. Management determines the adequacy of this allowance by regularly reviewing our accounts receivable aging and evaluating individual customer receivables, considering customers' financial condition, credit history and current economic conditions. If the financial condition of our customers were to deteriorate, resulting in an



impairment of their ability to make payments, additional allowances may be required.

**Inventories.** Inventories, which are predominantly blank garments or finished goods, are valued at the lower of cost or market, with cost determined using the first-in, first-out method. A detailed analysis of inventory is performed on a periodic basis throughout the year. If actual market conditions are less favorable than those projected by management, additional write-downs may be required.

**Impairment of Long-Lived Assets.** The Company reviews the carrying values of its long-lived assets whenever events or changes in circumstances indicate that such carrying values may not be recoverable. Unforeseen events, changes in circumstances, market conditions, and changes in estimates of future cash flows could negatively affect the fair value of the Company's assets and result in an impairment charge. Fair value is the amount at which the asset could be bought or sold in a current transaction between willing parties and may be estimated using a number of techniques, including quoted market prices or valuations by third parties, present value techniques based on estimates of cash flows, or multiples of earnings or revenues performance measures. The fair value of the asset could be different using different estimates and assumptions in these valuation techniques.

**Intangible Assets Valuation.** SFAS No. 142, Goodwill and Other Intangible Assets became effective for the Company during 2002. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles such as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential futu