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NITCHES INC
Form 10-Q
January 12, 2001

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: NOVEMBER 30, 2000

Commission File Number 0-13851

NITCHES, INC.

(Exact name of registrant as specified in its charter)

CALIFORNIA
(State of Incorporation)

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

10280 CAMINO SANTA FE, SAN DIEGO, CALIFORNIA 92121
(Address of principal executive offices)

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

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

| TITLE OF EACH CLASS ----- | NAME OF EACH EXCHANGE ON WHICH REGISTERED ----- |
|------------------------------|---|
| Common Stock, no par value | NASDAQ SmallCap Market |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No []

As of January 10, 2001, 1,064,680 shares of the Registrant's common stock were outstanding.

INDEPENDENT ACCOUNTANT'S REPORT

Board of Directors and Shareholders
Nitches, Inc.

We have reviewed the accompanying condensed consolidated balance sheet of Nitches, Inc. and Subsidiaries as of November 30, 2000, and the related condensed consolidated statements of income and cash flows for the three months ended November 30, 2000. These financial statements are the responsibility of management of Nitches, Inc.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the consolidated balance sheet of Nitches, Inc. and Subsidiaries as of August 31, 2000, and the related consolidated statements of income, shareholders' equity and cash flows for the year then ended not presented herein; and in our report dated October 13, 2000, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of August 31, 2000, is fairly presented, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Moss Adams, LLP

Los Angeles, California
January 8, 2001

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

NITCHES, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

| November 30, 2000 | August 31, 2000 |
|----------------------|--------------------|
| ----- | ----- |

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(Unaudited)

| ASSETS | | |
|--|--------------|--------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 73,000 | \$ 314,000 |
| Receivables: | | |
| Trade accounts, less allowances | 5,256,000 | 4,224,000 |
| Due from affiliates and employees | 33,000 | 38,000 |
| | ----- | ----- |
| | 5,289,000 | 4,262,000 |
| Inventories, net | 4,627,000 | 5,055,000 |
| Deferred income taxes | 150,000 | 150,000 |
| Other current assets | 47,000 | 76,000 |
| | ----- | ----- |
| Total current assets | 10,186,000 | 9,857,000 |
| | | |
| Furniture, fixtures and equipment, net | 101,000 | 109,000 |
| Deferred income taxes | 28,000 | 28,000 |
| Other assets | 19,000 | 17,000 |
| | ----- | ----- |
| | \$10,334,000 | \$10,011,000 |
| | ===== | ===== |

LIABILITIES AND SHAREHOLDER'S EQUITY

| | | |
|---|--------------|--------------|
| Current liabilities: | | |
| Accounts payable | \$ 2,523,000 | \$ 2,534,000 |
| Accrued expenses | 276,000 | 417,000 |
| Income tax payable | 323,000 | 98,000 |
| | ----- | ----- |
| Total current liabilities | 3,122,000 | 3,049,000 |
| | | |
| Shareholder's equity: | | |
| Common stock, no par value, 50,000,000 shares authorized; 1,064,680 shares issued and outstanding | 805,000 | 805,000 |
| Retained earnings | 6,407,000 | 6,157,000 |
| | ----- | ----- |
| Total shareholders' equity | 7,212,000 | 6,962,000 |
| | ----- | ----- |
| | \$10,334,000 | \$10,011,000 |
| | ===== | ===== |

The accompanying notes are an integral part of these financial statements

NITCHES, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(Unaudited)

Three months ended November 30,
2000 1999
----- -----

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| | | |
|---|---------------|---------------|
| Net sales | \$ 10,993,000 | \$ 11,527,000 |
| Cost of goods sold | 8,122,000 | 8,657,000 |
| | ----- | ----- |
| Gross profit | 2,871,000 | 2,870,000 |
| Expenses: | | |
| Selling, general and administrative | 1,961,000 | 1,928,000 |
| | ----- | ----- |
| Income from operations | 910,000 | 942,000 |
| Interest expense, net | (53,000) | (28,000) |
| | ----- | ----- |
| Income before income taxes | 857,000 | 914,000 |
| Provision for income taxes | 338,000 | 356,000 |
| | ----- | ----- |
| Net income | \$ 519,000 | \$ 558,000 |
| | ===== | ===== |
| Earnings per basic and diluted share: | \$.49 | \$.52 |
| | ===== | ===== |
| Weighted average number of basic shares | | |
| Outstanding | 1,064,680 | 1,064,680 |
| | ===== | ===== |
| Weighted average number of diluted | | |
| shares Outstanding | 1,064,680 | 1,064,680 |
| | ===== | ===== |

The accompanying notes are an integral part of these financial statements

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NITCHES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)

| | Three months ended November 30, 2000 | 1999 |
|--|---|----------------|
| | ----- | ----- |
| Net cash used by operating activities | \$ (2,793,000) | \$ (1,220,000) |
| Cash flows from financing activities: | | |
| Advances from factor | 2,818,000 | 1,528,000 |
| Dividends paid | (266,000) | (266,000) |
| | ----- | ----- |
| Net cash provided by financing activities | 2,552,000 | 1,262,000 |
| | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents | (241,000) | 42,000 |
| Cash and cash equivalents at beginning of period | 314,000 | 201,000 |
| | ----- | ----- |
| Cash and cash equivalents at end of period | 73,000 | 243,000 |
| | ===== | ===== |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period: | | |
| Interest | \$ 58,000 | \$ 38,000 |
| Income taxes | 113,000 | 32,000 |

The accompanying notes are an integral part of these financial statements

NITCHES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. DESCRIPTION OF BUSINESS

Nitches, Inc. (the "Company") is a wholesale importer and distributor primarily of women's clothing manufactured to its specifications and distributed in the United States under Company brand labels and private retailer labels.

2. CONDENSED FINANCIAL STATEMENTS:

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q. They have been reviewed by the Company's independent auditors in accordance with the professional standards and procedures as set forth in Statement of Auditing Standards No. 71 (SAS 71). SAS 71 procedures for conducting a review of interim financial information generally are limited to inquiries and analytical procedures concerning significant accounting matters relating to the financial information to be reported. They do not include all information and footnotes necessary for a fair presentation of financial position and results of operations and cash flows in conformity with generally accepted accounting principles. These consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in the Company's Annual Report on Form 10-K for the year ended August 31, 2000. In the opinion of Management, all adjustments considered necessary for a fair representation have been included in the interim period. Operating results for the three months ended November 30, 2000 are not necessarily indicative of the results that may be expected for the year ending August 31, 2001.

3. EARNINGS PER SHARE:

At November 30, 2000, there were no stock options outstanding and therefore no dilutive effect to the weighted average number of shares outstanding.

4. INVENTORIES:

| | November 30, 2000 | August 31, 2000 |
|------------------|----------------------|--------------------|
| | ----- | ----- |
| Fabric and Trims | \$ 303,000 | \$ 126,000 |
| Finished Goods | 4,324,000 | 4,929,000 |
| | ----- | ----- |
| | \$4,627,000 | \$5,055,000 |
| | ===== | ===== |

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5. TRADE ACCOUNTS:

Pursuant to the terms of an agreement between Nitches and a factor, Nitches sells a majority of its trade accounts receivable to the factor on a pre-approved, non-recourse basis. The Company may request advances in anticipation of customer collections and open letters of credit through the factor, all of which are collateralized by all of the Company's assets. Outstanding advances are charged interest at the factor's prime rate less one half percent. Advances and contingent liabilities for irrevocable letters of credit outstanding are as follows:

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NITCHES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statement (continued)

5. TRADE ACCOUNTS (CONTINUED):

| | November 30, 2000 ----- | August 31, 2000 ----- |
|--|-------------------------------|-----------------------------|
| Receivables assigned to factor: | | |
| Non-recourse | \$ 8,809,000 | \$ 4,986,000 |
| Recourse | 278,000 | 239,000 |
| Advances from factor | (3,814,000) | (996,000) |
| | ----- | ----- |
| Due from factor | 5,273,000 | 4,229,000 |
| Non-factored accounts receivable | 466,000 | 220,000 |
| Allowance for customer credits and doubtful accounts | (483,000) | (225,000) |
| | ----- | ----- |
| | \$ 5,256,000 | \$ 4,224,000 |
| | ===== | ===== |
| Contingent liabilities for irrevocable letters of credit | \$ 3,362,000 | \$ 4,510,000 |
| | ===== | ===== |

The factoring agreement allows the Company to borrow up to \$15,000,000, limited by certain percentages of outstanding accounts receivable and finished goods inventory owned by the Company. The President has provided a \$1,000,000 personal guarantee in connection with the factoring arrangement.

6. SPECIAL DIVIDENDS AND RELATED PARTY TRANSACTIONS:

The Company paid a special dividend of \$.25 (twenty-five cents) per share on November 30, 2000, for a total of approximately \$266,000, to the shareholders of record as of November 6, 2000. During fiscal 2000, the Company declared and paid special dividends of \$1.65 per share.

The Company purchases labor and administrative services, as needed, at fair market rates, from Kuma Sport, Inc. that is 40% owned by a director of Nitches. The Company purchased labor and administrative services from Kuma Sport, Inc. for \$256,000 in the first three months of fiscal 2001.

7. SIGNIFICANT CUSTOMERS:

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Sales to three separate customers (Mervyn's, Kohl's, and Sears) accounted for 60.3%, 15.4%, and 13.0%, respectively, of the Company's net sales in the quarter ended November 30, 2000. Sales to two customers (Mervyn's and JC Penney) accounted for 46.3% and 17.1% of the Company's net sales in the quarter ended November 30, 1999.

These same customers accounted for 35.6%, 15.7%, and 15.1%, respectively, of the Company's trade receivable balance at November 30, 2000. Sales to three customers accounted for 48.1%, 13.1%, and 8.1%, respectively, of the Company's trade receivable balance at November 30, 1999.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

RESULTS OF OPERATIONS

Net sales for the three months ended November 30, 2000 decreased approximately \$534,000 (4.6%) as compared to the three months ended November 30, 1999. This decline was primarily attributable to a decrease in unit sales in the Company's private label sleepwear product line. Private label sales are the result of a joint product development effort and the use of the retailers' label on the product.

Gross margins increased from 24.9% for the three months ended November 30, 1999 to 26.1% for the current three-month period. The increase was the result of higher gross margins in the Company's sleepwear product line during the first quarter. The Company's product mix constantly changes to reflect customer mix, fashion trends and changing seasons. Consequently, gross margins are likely to vary on a quarter-to-quarter basis and in comparison to gross margins generated in the same period of prior fiscal years.

Selling, general and administrative expenses for the first three months of fiscal 2001 were equal to the \$1.9 million from last year, and increased as a percent of net sales from 16.6% last year to 17.8% for the current period. The primary reason for the increase as a percentage of sales was due to the decrease in net sales from the earlier period.

LIQUIDITY AND CAPITAL RESOURCES

Working capital of \$7.1 million at November 30, 2000 increased from the August 31, 2000 level of \$6.8 million, and the current ratio increased to 3.26:1 at November 30, 2000 from 3.20:1 at August 31, 2000.

The Company paid a special dividend of \$.25 (twenty-five cents) per share on November 30, 2000, for a total of approximately \$266,000, to the shareholders of record as of November 6, 2000.

The Company sells substantially all of its trade receivables to a factor (CIT) on a pre-approved, non-recourse basis. The Company attempts to make any recourse shipments on a COD basis or ensure that the customers' payments are backed by a commercial or standby letter of credit issued by the customer's bank. The amount of the Company's receivables which were recourse and were not made on a COD basis or supported by commercial or standby letters of credit at November 30, 2000 was approximately \$722,000 of which approximately \$460,000 has been collected through December 31, 2000.

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Payment for non-recourse factored receivables is made at the time customers make payment to CIT or, if a customer is financially unable to make payment, within approximately 180 days of the invoice due date. Under the Discount Factoring Agreement, the Company can request advances in anticipation of customer collections at CIT's prime rate (currently 9.5%) less one-half percent, and open letters of credit through CIT. The amount of borrowings by the Company, including a portion of outstanding letters of credit, are limited to certain percentages of outstanding accounts receivable and finished goods inventory owned by the Company. Borrowings are collateralized by all of the assets of the Company as well as a \$1 million guaranty of the Company's president, Mr. Wyandt. At November 30, 2000, the Company had outstanding letters of credit of approximately \$3.4 million for the purchase of finished goods, which had been opened through CIT. Under the Discount Factoring Agreement, the Company is required to maintain \$5 million of net worth and \$5 million of working capital. The Discount Factoring Agreement can be terminated by CIT on 60-days written notice.

INVENTORY

In its ordinary course of operations, the Company generally makes some sales below its normal selling prices or below cost. Based on prior experience, management believes this will be true for some inventory

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held or acquired after November 30, 2000. The amount of such sales depends on several factors, including general economic conditions, market conditions within the apparel industry, the desirability of the styles held in inventory and competitive pressures from other garment suppliers.

The Company's inventory decreased from \$5.1 million at August 31, 2000 to \$4.6 million at November 30, 2000. The Company has established an inventory markdown reserve as of November 30, 2000, which management believes will be sufficient for current inventory that is expected to be sold below cost in the future. There can be no assurance that the Company will realize its expected selling prices, or that the inventory markdown reserve will be adequate, for items in inventory as of November 30, 2000 for which customer sales orders have not yet been received. The inventory markdown reserve is calculated based on specific identification of aged goods and styles that are slow moving or selling off-price.

BACKLOG

The Company had unfilled customer orders of \$14.5 million at November 30, 2000 and 1999, with such orders generally scheduled for delivery by April 2001 and April 2000, respectively. These amounts include both confirmed orders and unconfirmed orders that the Company believes, based on industry practice and past experience, will be confirmed. While cancellations, rejections and returns have generally not been material in the past, there can be no assurance that cancellations, rejections and returns will not reduce the amount of sales realized from the backlog of orders at November 30, 2000.

IMPACT OF EXCHANGE RATES

While the Company purchases over 90% of its products from foreign manufacturers, all of its purchases are denominated in United States dollars. Because the Company's products are sold primarily in the United States, in dollar denominated transactions, the Company does not engage in hedging or other arbitrage to reduce currency risk. An increase in the value of the dollar versus

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foreign currencies could enhance the Company's purchasing power for new purchase orders and reduce its cost of goods sold. Conversely, a decrease in the value of the dollar relative to foreign currencies could result in an increase in the Company's cost of manufacturing for new purchase orders and costs of goods sold.

IMPACT OF INFLATION AND DEFLATION

Management does not believe that inflation has had any material impact upon the Company's revenues or income from operations to date. However, continued deflation in women's clothing prices may put pressure on gross margins for the balance of fiscal 2001. The strong resistance on the part of the consumer to increases in price and increasing fabric and labor costs lead to an increased cost of goods on a percentage basis.

CAUTIONARY STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

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

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

There were no material legal proceedings to which the Company or any of its subsidiaries was a party in the quarter ended November 30, 2000.

Item 2. Exhibits and Reports on Form 8-K

There were no reports on Form 8-K during the quarter ended November 30, 2000.

SIGNATURES

Pursuant to the requirement of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned there unto duly authorized.

NITCHES, INC.

Registrant

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January 12, 2001

By: /s/ Steven P. Wyandt

Steven P. Wyandt
As Principal Financial Officer
and on behalf of the Registrant