NITCHES INC
Form 10-Q/A
January 31, 2007

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q/A

Amendment No. 2

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

For the quarterly period ended: May 31, 2006

Commission File Number 0-13851

NITCHES, INC.

(Exact name of registrant as specified in its charter)

California	**95-2848021**
(State of Incorporation)	(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 Capital Market

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes |_| No |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 July 20, 2006 the Registrant had 4,653,507 shares of common stock outstanding.

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EXPLANATORY NOTE

We filed our Quarterly Report on Form 10-Q for the period ended May 31, 2006 (the Original Filing) with the Securities and Exchange Commission on July 21, 2006. In that Original Filing we stated under Part I, Item 4 that, in the opinion of our chief executive and financial officer, our disclosure controls and procedures were effective to ensure that material information related to our company was recorded, processed and reported within the time periods specified by the Securities and Exchange Commission (the SEC).

On December 20, 2006, we filed Amendment No. 1 to our 10-Q for the period ended May, 31, 2006 (the First Amendment) to revise our chief executive and financial officers opinion concerning the effectiveness of our disclosure controls and procedures. We noted that in light of the fact that we had extended the filing date for each of our Quarterly Reports on Form 10-Q during our fiscal year ended August 31, 2006, and had filed for an extension of time in which to file our Annual Report on Form 10-K for that fiscal year, our chief executive and financial officer determined that we had a deficiency in our disclosure controls and procedures as of May 31, 2006. In addition, our Original Filing omitted to include the disclosure of changes in our internal controls over financial reporting during the period which was included in our First Amendment.

We are filing this Amendment No. 2 on Form 10-Q/A to provide additional detail concerning the nature of the deficiency in our disclosure controls that existed as of May 31, 2006 and our efforts to remediate that deficiency, and to revise our disclosure concerning the inherent limitations of disclosure controls and procedures.

This Amendment No. 2 on Form 10-Q/A amends and restates Item 4. Controls and Procedures, of our Original Filing, solely as a result of, and to reflect, the impact of the items discussed in this Explanatory Note. While we have presented our complete financial statements with this Amendment No. 2 on Form 10-Q/A, those financial statements remain unchanged from the Original Filing.

Pursuant to the rules of the Securities and Exchange Commission, we have included currently-dated certifications from our chief executive and financial officer, as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. Except as otherwise specifically noted, all information contained herein is as of May 31, 2006 and does not reflect events or changes that have occurred subsequent to that date.

PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

NITCHES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	May 31, 2006	August 31, 2005
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 371,000	$ 192,000
Receivables:		
Due from factor, net	7,292,000	3,749,000
Trade accounts, net	25,000	473,000
Due from affiliates and employees	20,000	11,000

Total receivables	7,337,000	4,233,000
Refundable income taxes		212,000
Inventories, less allowances	6,392,000	4,582,000
Deferred income taxes, current	600,000	867,000
Other current assets	456,000	302,000
Total current assets	15,156,000	10,388,000
Property and equipment, net	218,000	38,000
Goodwill and trademarks	3,539,000	
Other intangibles subject to amortization, net	669,000	
Deferred income taxes, net of current	477,000	10,000
Other assets	30,000	17,000
	$ 20,089,000	$ 10,453,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Due to factor	$ 6,659,000	$ 3,131,000
Accounts payable	4,592,000	2,276,000
Accrued expenses	1,035,000	640,000
Income taxes payable	1,145,000	
Total current liabilities	13,431,000	6,047,000
Long term liabilities:		
Loss on investment in Designer Intimates, Inc.		146,000
Shareholders equity:		
Series A preferred stock, $100 par value; 25,000,000 shares authorized, 8,820 shares issued and outstanding (0 - August 31, 2005)	882,000	
Common stock, no par value; 50,000,000 shares authorized; 4,053,507 shares issued and outstanding (3,513,507 - August 31, 2005)	2,413,000	1,495,000
Retained earnings	3,363,000	2,765,000
Total shareholders equity	6,658,000	4,260,000
	$ 20,089,000	$ 10,453,000

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

NITCHES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended May 31,	Nine Months Ended May 31,

	2006	2005	2006	2005
Net sales	$ 12,580,000	$ 7,403,000	$ 39,609,000	$ 20,261,000
Cost of goods sold	8,880,000	5,808,000	28,017,000	15,756,000
Gross profit	3,700,000	1,595,000	11,592,000	4,505,000
Selling, general and administrative expenses	3,507,000	2,216,000	9,794,000	6,091,000
Income (loss) from operations	193,000	(621,000)	1,798,000	(1,586,000)
Interest expense	(136,000)	(40,000)	(359,000)	(70,000)
Other income		456,000	1,000	456,000
Income (loss) from equity investment		(66,000)	(11,000)	8,000
Income (loss) before income tax provision (benefit)	57,000	(271,000)	1,429,000	(1,192,000)
Provision (benefit) for income taxes	24,000	(83,000)	831,000	(468,000)
Net income (loss)	$ 33,000	$ (188,000)	$ 598,000	$ (724,000)
Earnings (loss) per weighted average share	$ 0.01	$ (0.05)	$ 0.15	$ (0.21)
Weighted average common shares outstanding	4,053,507	3,513,507	3,948,672	3,513,507

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

NITCHES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY
(Unaudited)

For the Nine Months Ended May 31, 2005

	Preferred Stock		Common Stock			
	Shares	Amount	Shares	Amount	Retained Earnings	Total Shareholders Equity
Balance, August 31, 2004		$	3,513,507	$ 1,495,000	$ 3,967,000	$ 5,462,000
Net loss					(724,000)	(724,000)
Balance, May 31, 2005		$	3,513,507	$ 1,495,000	$ 3,243,000	$ 4,738,000

For the Nine Months Ended May 31, 2006

	Preferred Stock		Common Stock			
	Shares	Amount	Shares	Amount	Retained Earnings	Total Shareholders Equity
Balance, August 31, 2005		$	3,513,507	$ 1,495,000	$ 2,765,000	$ 4,260,000
Shares issued in transaction	8,820	882,000	540,000	918,000		1,800,000

Net income								598,000		598,000
Balance, May 31, 2006	8,820	$	882,000	4,053,507	$	2,413,000	$	3,363,000	$	6,658,000

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)

	Nine Months Ended May 31,			
	2006		**2005**	
Net income/(loss)	$	598,000	$	(724,000)
Cash flows from operating activities:				
Depreciation and amortization		206,000		21,000
(Income) loss from investment in unconsolidated subsidiary		11,000		(8,000)
Decrease in due from factor		439,000		705,000
(Increase) decrease in trade receivables		(157,000)		720,000
(Increase) decrease in refundable income taxes		212,000		(765,000)
Decrease in deferred income taxes receivables				180,000
(Increase) decrease in inventories		1,759,000		(1,065,000)
Increase in other assets		(59,000)		
Increase (decrease) in accounts payable and accrued expenses		(3,660,000)		153,000
Increase in income taxes payables		667,000		
Net cash provided (used) by operating activities	$	16,000	$	(783,000)
Cash flows used by investing activities:				
Acquisition cost of transaction		(102,000)		
Capital expenditures		(37,000)		(12,000)
Cash acquired in transaction		127,000		
Net cash used by investing activities	$	(12,000)	$	(12,000)
Cash flows provided by financing activities:				
Advances from factor	$	175,000	$	1,173,000
Net increase in cash and cash equivalents		179,000		378,000
Cash and cash equivalents at beginning of period		192,000		219,000
Cash and cash equivalents at end of period	$	371,000	$	597,000
Supplemental disclosures of cash flow information:				
Cash paid during the period:				

Interest	$	359,000	$	70,000
Income taxes		180,000		141,000
Non-cash investing activity:				
Acquisition of remaining outstanding shares of subsidiary				
Common stock issued	$	918,000	$	
Series A preferred stock issued		882,000		
	$	1,800,000	$	

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

NITCHES, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

1. Description of Business:

Nitches, Inc. (the Company) is a wholesale importer and distributor of clothing manufactured to its specifications and distributed in the United States under Company brand labels and private retailer labels. Nitches currently distributes men s casual lifestyle clothing by Newport Blue®, men s golf apparel by The Skins Game®, women s sleepwear by Body Drama® and women s western wear by Adobe Rose® and Southwest Canyon®. With the recent acquisition of Designer Intimates, the Company now also markets sleepwear and loungewear under the following brands: Argentovivo®, Derek Rose®, Princesse tam tam®, Crabtree & Evelyn®, The Anne Lewin® Collection, The Bill Blass® Lifestyle Collection, The Dockers® Collection, The Claire Murray® Collection and The Vassarette® Collection. Products are sold to better department stores, specialty boutiques, moderate department stores, and national and regional discount department stores. The Company also develops and manufactures private label products for many leading retailers and multi-channel marketers.

2. Condensed Financial Statements:

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q. 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 in the United States of America. 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, 2005. In the opinion of Management, all adjustments considered necessary for a fair presentation have been included in the interim period. Operating results for the nine months ended May 31, 2006 are not necessarily indicative of the results that may be expected for the year ending August 31, 2006.

3. Earnings Per share:

At May 31, 2006, there were no stock options or similar instruments outstanding and therefore no dilutive effect to the number of shares outstanding. The earnings per share computations have been adjusted retroactively for all periods presented to reflect a 200% stock dividend issued on January 20, 2006.

4. Inventories:

	May 31, 2006	August 31, 2005
Fabric and trim	$ 249,000	$ 254,000
Work in progress	1,548,000	1,530,000
Finished goods	5,227,000	2,883,000
Markdown allowances	(632,000)	(85,000)
	$ 6,392,000	$ 4,582,000

5. Trade accounts receivable and amounts due to factor:

Pursuant to the terms of an agreement between Nitches and a factor, Nitches sells a majority of its trade accounts receivable to the factor on a pre-approved, non-recourse basis. The price at which the accounts are sold is the invoice amount reduced by the factor commission (0.3% of the invoice amount) and all selling discounts. For accounts sold to the factor without recourse, the factor is responsible for collection, assumes all credit risk, and obtains all of the rights and remedies against the company s customers. For such accounts, payment is due from the factor upon the earlier of the payment of the receivable to the factor by the customer, or the maturity of the receivable (generally 180 days from the date of shipment to the customer). As of May 31, 2006, non-recourse receivables totaled $7.6 million.

Trade accounts receivable not sold to the factor remain in the custody and control of the Company and the Company maintains all credit risk on those accounts as well as accounts which are sold to the factor with recourse. The combined credit risk for non-factored and recourse receivables as of May 31, 2006, totaled $355,000, of which $199,000 had been collected by June 30, 2006.

NITCHES, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statement (continued)

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

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

	May 31, 2006	August 31, 2005
Receivables assigned to factor:		
Non-recourse	$ 7,563,000	$ 3,827,000
Recourse	282,000	110,000
Allowance for customer credits and doubtful accounts	(553,000)	(188,000)
Due from factor, net	$ 7,292,000	$ 3,749,000
Non-factored accounts receivable	73,000	557,000
Allowance for customer credits and doubtful accounts	(48,000)	(84,000)
Trade receivables, less allowances	$ 25,000	$ 473,000
Due to factor	$ 6,659,000	$ 3,131,000
Contingent liabilities for irrevocable letters of credit	$ 2,643,000	$ 3,520,000

6. Dividends:

The Company did not pay any cash dividends during the current period or the prior fiscal year. On January 20, 2006 the Company issued a 200% stock dividend to shareholders of record as of January 3, 2006.

7. Significant Customers:

For the nine months ended May 31, 2006, sales to two separate customers accounted for 36.7% of the Company s net sales. Sales to one customer accounted for 55.0% of the Company s net sales for the nine months ended May 31, 2005. Sales to two separate customers accounted for 43.8% of the Company s net sales in the three months ended May 31, 2006. Sales to one customer accounted for 43.0% of the Company s net sales in the three months ended May 31, 2005.

One customer accounted for 27.9% respectively of the Company s trade receivable balance as of May 31, 2006. Two customers accounted for 58.6% of the Company s trade receivable balance as of May 31, 2005.

8. Acquisition of Designer Intimates, Inc.:

On October 24, 2005, the Company acquired the remaining seventy-two percent (72%) of the issued and outstanding stock of Designer Intimates, Inc., a Delaware corporation (Designer Intimates) which Nitches did not own, resulting in the Company owning one hundred percent (100%) of Designer Intimates. The aggregate purchase price for the acquisition was $1,800,000. Nitches issued to the Sellers 540,000 restricted shares of its common stock at a value of $1.70 per share totaling $918,000 and 8,820 shares of Series A preferred stock at a value of $882,000.

The primary reason for the acquisition was to acquire the trademarks and brand licenses to complement the Company s broad production base. The assets of Designer Intimates, which owns 100% of NAP, Inc., a New York-based intimate apparel company, include cash, finished goods inventory, customer lists, customer orders, trademarks, brand licenses, brand distribution agreements, office leases in New York City and Atlanta, and office equipment, furniture and fixtures, all of which Nitches intends to continue to use.

The transaction is being accounted for using the purchase method of accounting. The purchase price is in excess of the fair value of assets and liabilities acquired by $4,849,000 and is expected to be allocated to (i) trademarks that are not anticipated to be subject to amortization because of their indefinite life, (ii) goodwill that will not be subject to amortization but will be subject to yearly evaluation for write-down, (iii) licenses, among others, that will be subject to amortization based on the estimated useful life of the licenses, and (iv) to increase the value of purchased inventories to reflect estimated selling prices less cost of disposal and a reasonable profit allowance. A final determination of the fair values of assets and liabilities acquired will be made after all available evidence has been obtained to reliably estimate those values.

The Company acquired its initial 28% interest in Designer Intimates in October 2002. Designer Intimates had acquired NAP from its founders and obtained a credit line of approximately $12 million from HSBC, later assumed by CIT, secured by the inventory and accounts receivable of NAP and the guarantees of shareholders of Designer Intimates. Nitches guaranteed $3.0 million of this credit line and this guaranty formed the consideration from Nitches for its 28% ownership interest in Designer Intimates.

9. Pro Forma Financial Information:

The pro forma financial information presented below gives effect to the acquisition of Designer Intimates as if it occurred as of the beginning of fiscal 2006 and 2005. For fiscal 2006, the post acquisition results are reflected in the Company s results of operations as of October 24, 2005 and pro forma results for the period September 1, 2005 to October 23, 2005 are included below.

	Nine Months Ended May 31,	
	2006	**2005**
Net sales	$ 44,953,000	$ 60,302,000
Net income (loss)	543,000	(779,000)
Net income (loss) per weighted average share	$ 0.13	$ (0.19)
Weighted average shares outstanding	4,053,507	4,053,507

10. Goodwill and Intangible Assets:

Goodwill and Other Intangible Assets consisted of the following at October 24, 2005 and May 31, 2006:

	May 31, 2006	October 24, 2005
Goodwill & trademarks	$ 3,539,000	$ 3,524,000
Other intangibles	$ 728,000	$ 721,000
Accumulated amortization	(59,000)	
	$ 669,000	$ 721,000

The Goodwill & Trademarks represents the excess purchase price over the fair value of the net assets acquired with Designer Intimates, Inc. and is not subject to amortization. In accordance with SFAS 142 it will be tested for impairment on an annual basis and between annual tests in certain instances (see Valuation of Goodwill, Long-lived Assets and Intangible Assets). The Other Intangibles is the license for Crabtree & Evelyn which is being amortized through December 31, 2012.

NITCHES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statement (continued)

The estimated aggregate amortization expense for intangible assets for each of the five succeeding fiscal years is:

2006	$ 100,000
2007	100,000
2008	100,000
2009	100,000
2010	100,000

11. New Accounting Pronouncements:

The FASB did not issue any new Statements of Financial Accounting Standards during the current period that were applicable to the Company.

12. Reclassification:

The due to and from factor captions on the August 31, 2005 condensed consolidated balance sheet and May 31, 2005 condensed consolidated statement of cash flows have been reclassified to conform to the May 31, 2006 financial statement presentation.

13. Subsequent events:

On June 23, 2006 the Company announced plans to acquire the Saguaro® mark and related trademarks from Impex Inc., a leading manufacturer of branded and non-branded specialty, western, and private-label apparel. Since January 2005, Nitches has been manufacturing and distributing Saguaro® apparel products to specialty and catalog retailers under the terms of a strategic alliance with Impex. Under this alliance, Nitches has recorded the revenue from such sales and remitted royalties and design fees to Impex as part of its operating expenses. Upon the closing of the Acquisition Agreement, Nitches will no longer be required to pay such fees to Impex. Accordingly, profit margins for the Saguaro® products are expected to increase. Consideration paid to Impex will be in the form of 600,000 shares of Nitches common stock and a $300,000 promissory note. The transaction is contingent upon certain conditions, including the successful registration of the shares to be issued to Impex. Either party has a right to terminate the agreement if the closing has not occurred by September 30, 2006.

On July 1, 2006 the Company acquired the Home Décor business of Taresha LLC for 600,000 shares of Nitches common stock. Assets acquired included inventory, order backlog, customer lists, licenses and license agreements. As part of the transaction Nitches will retain all key executives in product development, sales and production.

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

CRITICAL ACCOUNTING POLICIES

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

Allowances for Sales Returns, Doubtful Accounts and Other. Sales are recorded net of estimated future returns, uncollectible accounts receivable and other customer related allowances. Management analyzes historical returns and bad debt expense, current economic trends, changes in customer demand and sell-through of our products when evaluating the adequacy of these allowances. In addition, the Company may provide warehousing credits and other allowances to certain customers in accordance with industry practice. These reserves are determined based on historical experience, budgeted customer allowances and existing commitments to customers. Although management believes it has established adequate reserves with respect to these items, actual activity could vary from management s estimates and such variances could have a material impact on reported results. At May 31, 2006, trade accounts receivable balance was $658,000, net of allowances of $601,000 and factor advances of $6.7 million, as compared to the balance of $1.1 million, net of allowances of $272,000 and factor advances of $3.1 million at August 31, 2005. At May 31, 2005, the trade accounts receivable balance was $1.2 million, net of allowances of $275,000.

Inventory. The Company marks down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated net realizable value based on assumptions about age of the inventory, future demand and market conditions. This process provides for a new basis for the inventory until it is sold. If actual market conditions are less favorable than those projected by management, additional inventory markdowns may be required. The Company s inventory balance was $6.4 million, net of inventory markdowns of $632,000, at May 31, 2006, as compared to an inventory balance of $4.6 million, net of inventory markdowns of $85,000, at August 31, 2005. At May 31, 2005, the inventory balance was $4.1 million, net of inventory markdowns of $75,000.

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

Valuation of Goodwill, Long-Lived Assets and Intangible Assets. The Company evaluates goodwill, long-lived assets and intangible assets for potential impairment on an annual basis during the fourth fiscal quarter, subsequent to the completion of financial projections for the following fiscal year. The Company may make an evaluation between annual tests in certain circumstances such as a significant change in business climate, unanticipated competition, loss of key personnel, or adverse action or assessment by a regulator such as import quotas or duties. Any of these circumstances could cause the Company to conclude that impairment exists and that the net book value of goodwill, long-lived assets and/or intangible assets is impaired. Any resulting impairment loss could have a material adverse impact on the Company s financial condition and results of operations.

Contingencies and Litigation. Management evaluates contingent liabilities including threatened or pending litigation in accordance with SFAS No. 5, Accounting for Contingencies and records accruals when the outcome of these matters is deemed probable and the liability can be reasonably estimated.

Results of Operations

Nine Months Ended May 31, 2006 Compared to the Nine Months Ended May 31, 2005

Net sales for the nine months ended May 31, 2006, increased $19.3 million or 95.5% as compared to the nine months ended May 31, 2005. This increase was primarily attributable to the acquisition of Designer Intimates early in the current period. Increased shipments of the Company s sleepwear and menswear product lines as well as the addition of women s private label apparel also contributed to the increase in net sales.

Cost of sales as a percent of net sales decreased 7.1% generating a higher gross profit margin of 29.3% for the nine months ended May 31, 2006 as compared to 22.2% for the year earlier period. The increase in gross margin came primarily as the result of the addition of higher gross margin sales from Designer Intimates, as well as higher earned gross margins in the Company s menswear product line. The Company s product mix constantly changes to reflect customer mix, fashion trends and changing seasons. Consequently, gross margin is likely to vary on a quarter-to-quarter basis and in comparison to gross margins generated in the same period of prior fiscal years.

Selling, general and administrative expenses for the first nine months of fiscal 2006 increased $3.7 million as compared to a year ago, due primarily to the consolidation of selling, general and administrative costs for Designer Intimates. Expenses included $4.2 million of selling and merchandising expenses and $1.4 million of warehousing and distribution expenses. This compares with $3.7 million of selling and merchandising expenses and $1.0 million of warehousing and distribution expenses incurred during the nine months ended May 31, 2005. Expenses as a percent of net sales decreased to 24.7% from 30.1% in the prior period, due primarily to the inclusion of higher sales from Designer Intimates at a correspondingly lower selling, general and administrative expense rate, and secondarily to increased sales and improved expense management across Nitches product lines.

Interest expense increased $289,000 in the current period to $359,000 as compared to $70,000 for the nine months ended May 31, 2005. This increase was due primarily to increased advances under the Company s factoring agreement and the inclusion of the interest expense of Designer Intimates. Interest expense was also impacted by higher interest rates charged on advances due to increases in the prime lending rate from 5.75% at May 31, 2005 to 7.75% at May 31, 2006.

The Company s income tax provision for the six months ended May 31, 2006 reflects $831,000 of tax expense accrued at an average 42% tax rate on pretax income before this income was reduced by the purchase accounting effect of a non-taxable increase in cost of goods to reflect the write up of the inventory of Designer Intimates to fair market value. The Company utilized an estimated tax rate of 39% for the nine months ended May 31, 2005 to recognize a $468,000 tax benefit on a pretax loss of $1,192,000.

Three Months Ended May 31, 2006 Compared to the Three Months Ended May 31, 2005

Net sales for the three months ended May 31, 2006, increased $5.2 million or 69.9% as compared to the three months ended May 31, 2005. The increase was primarily attributable to the inclusion in the current period of sales from Designer Intimates which was acquired early in the current fiscal year. An increase in shipments during the current period of the company s menswear product line also contributed to the increase in net sales.

Cost of sales as a percent of net sales decreased 7.9%, generating a higher gross profit margin of 29.4% for the three months ended May 31, 2006 as compared to 21.5% for the year earlier period. The increase in gross margin came primarily as the result of the addition of higher gross margin sales from Designer Intimates. The Company s product mix constantly changes to reflect customer mix, fashion trends and changing seasons. Consequently, gross margin is likely to vary on a quarter-to-quarter basis and in comparison to gross margins generated in the same period of prior fiscal years.

Selling, general and administrative expenses for the three months ended May 31, 2006 increased $1.3 million as compared to a year ago, due to the consolidation of selling, general and administrative costs for Designer Intimates. Expenses included $1.4 million of selling and merchandising expenses and $0.5 million of warehousing and distribution expenses. This compares with $1.4 million of selling and merchandising expenses and $0.3 million of warehousing and distribution expenses incurred during the three months ended May 31, 2005. Expenses as a percent of net sales decreased to 27.9% from 29.9% in the prior period, due to increased sales and improved expense management across Nitches product lines and in spite of the inclusion of sales from Designer Intimates at a correspondingly higher selling, general and administrative expense rate.

Interest expense increased $96,000 in the current period to $136,000 as compared to $40,000 for the three months ended May 31, 2005. This increase was due to higher interest rates charged on increased advances under the Company s factoring agreement, as well as the inclusion of the interest expense of Designer Intimates.

The Company s income tax provision for the three months ended May 31, 2006 reflects $24,000 of tax expense accrued at an average 41% tax rate on pretax income.

Acquisition of Designer Intimates, Inc.

On October 24, 2005, the Company acquired the remaining seventy-two percent (72%) of the issued and outstanding stock of Designer Intimates, Inc., a Delaware corporation (Designer Intimates) which Nitches did not own, resulting in the Company owning one hundred percent (100%) of Designer Intimates. The aggregate purchase price for the acquisition was $1,800,000. Nitches issued to the Sellers 540,000 restricted shares of its common stock at a value of $1.70 per share totaling $918,000 and 8,820 shares of Series A preferred stock at a value of $882,000.

The primary reason for the acquisition was to acquire the trademarks and brand licenses to complement the Company s broad production base. The assets of Designer Intimates, which owns 100% of NAP, Inc., a New York-based intimate apparel company, include cash, finished goods inventory, customer lists, customer orders, trademarks, brand licenses, brand distribution agreements, office leases in New York City and Atlanta, and office equipment, furniture and fixtures, all of which Nitches intends to continue to use.

The transaction is being accounted for using the purchase method of accounting. The purchase price is in excess of the fair value of assets and liabilities acquired by $4,849,000 and is expected to be allocated to (i) trademarks that are not anticipated to be subject to amortization because of their indefinite life, (ii) goodwill that will not be subject to amortization but will be subject to yearly evaluation for write-down, (iii) licenses, among others, that will be subject to amortization based on the estimated useful life of the licenses, and (iv) to increase the value of purchased inventories to reflect estimated selling prices less cost of disposal and a reasonable profit allowance. A final determination of the fair values of assets and liabilities acquired will be made after all available evidence has been obtained to reliably estimate those values.

The Company acquired its initial 28% interest in Designer Intimates in October 2002. Designer Intimates had acquired NAP from its founders and obtained a credit line of approximately $12 million from HSBC, later assumed by CIT, secured by the inventory and accounts receivable of NAP and the guarantees of shareholders of Designer Intimates. Nitches guaranteed $3.0 million of this credit line and this guaranty formed the consideration from Nitches for its 28% ownership interest in Designer Intimates.

Liquidity and Capital Resources

For the period ended May 31, 2006 cash provided by operating activities was approximately $16,000, whereas for the prior period ended May 31, 2005 cash used by operating activities was approximately $783,000. The cash provided by operating activities during the period ended May 31, 2006, derived from net income and decreases in amounts due from factor and inventories, offset substantially by a decrease in accounts payable and accrued expenses. Current period amounts include the effect of balances acquired in the acquisition of Designer Intimates. For the period ended May 31, 2005, cash used by the net loss and an increase in inventories was offset partially by a reduction in amounts due from factor and trade receivable due to decreased sales during the quarter.

For the period ended May 31, 2006, net cash used by investing activities of $12,000 derived from the cost of the acquisition as well as capital expenditures on equipment and leasehold improvements, offset by the acquisition of cash balances of Designer Intimates. Minimal cash was used in the prior period for the purchase of furniture and equipment used in the ordinary course of business operations.

For the period ended May 31, 2006, net cash provided by financing activities was approximately $175,000 as compared to $1.2 million for the prior period ended May 31, 2005. For each of these periods cash provided by financing activities was attributable to advances from the Company s factor in accordance with the terms of the factoring agreement. Current period amounts include the effect of balances acquired in the acquisition of Designer Intimates.

Working capital decreased to $1.7 million at May 31, 2006 from $4.3 million at August 31, 2005. The current ratio decreased to 1.1:1 at May 31, 2006 from 1.7:1 at August 31, 2005. These decreases resulted from the consolidation of higher liabilities and correspondingly lower current assets due to the Designer Intimates acquisition.

The Company sells substantially all of its trade receivables to a factor (CIT) on a pre-approved, non-recourse basis. The Company attempts to make any recourse shipments on a COD basis or ensure that the customers payments are backed by a commercial or standby letter of credit issued by the customers bank. The amount of the Company s receivables that were recourse and were not made on a COD basis or supported by commercial or standby letters of credit at May 31, 2006 totaled $355,000, of which $199,000 had been collected by June 30, 2006.

Payment for non-recourse factored receivables is made at the time customers make payment to CIT or, if a customer is financially unable to make payment, within approximately 180 days of the invoice due date. Under the factoring agreement, the Company can request advances in anticipation of customer collections at the prime rate (currently 7.75%) less one and one-half percent (1.5%). The amount of advances available to the Company is limited to eighty-five percent (85%) of non-recourse factored receivables.

The Company may issue import letters of credit through CIT for the purchase of inventory in the normal course of its operations. Letters of credit are subjected to a limit of $12 million. At May 31, 2006, the Company had outstanding letters of credit of approximately $2.6 million for the purchase of finished goods, which had been opened through CIT.

The factoring agreement does not contain any financial covenants to which the Company must adhere. Advances are collateralized by all of the assets of the Company as well as a personal guaranty of the Company s Chairman. The factoring agreement can be terminated by CIT on 30-days written notice. The company believes the factoring agreement with CIT, along with expected cash flow from operating activities and current levels of working capital are adequate to fulfill the Company s liquidity needs for the foreseeable future.

Contractual Obligations and Commercial Commitments

	Payments due/Commitments expiring per period				
	Total Amounts Committed	**Less than 1 year**	**1-3 years**	**4-5 years**	**Over 5 years**
Operating leases	715,000	$ 648,000	$ 67,000		
License royalty minimums	47,000	7,000	40,000	13,000	
Letters of credit	2,643,000	2,643,000			
Guarantees	3,000,000			3,000,000 *	
Total obligations & commitments	$ 6,405,000	$ 3,298,000	$ 107,000	$ 3,013,000	$

** Due on demand*

Inventory

The Company s inventory increased 39.2% to $6.4 million at May 31, 2006, from $4.6 million at August 31, 2005. Compared to inventories of $4.1 million at May 31, 2005, inventories ending the current period increased 12.2%, primarily because the Company maintains additional inventory due to the acquisition of Designer Intimates. The Company believes that its current inventory mix and unit levels are appropriate to respond to anticipated market demand.

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 held on or acquired after May 31, 2006. 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 has established an inventory markdown reserve as of May 31, 2006, which management believes will be sufficient for current inventory that is expected to sell 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 May 31, 2006 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

As of May 31, 2006, the Company had on-hand unfilled customer orders of $38.8 million as compared to $13.6 million at May 31, 2005, with such orders generally scheduled for delivery by November 2006 and 2005, respectively. The increase in backlog of $25.2 million is due to the addition of $14.7 million in orders as a result of the acquisition of Designer Intimates, $2.2 million from the acquisiton of the Home Decor product line, and increases in the company s women s sleepwear and sportswear lines, offset partially by a decrease in orders for western wear and golf apparel.

Backlog amounts include both confirmed 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 May 31, 2006. Because of the Company s reliance upon a few major accounts, any deteriorating financial performance by one or more of these customers could lead to the cancellation of existing orders and/or an inability to secure future orders, which would have a material adverse financial effect on the Company.

Impact of Exchange Rates

While the Company purchases over 85% 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 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. Management believes that the apparel sector in which the Company operates has been in a period of deflation, contrary to the modest inflation experienced in the economy in general. The persistence of the consumer to buy on sale merchandise has put pressure on retail gross margins, which in turn has led to downward pressure from retailers on wholesale gross margins, in the form of selling cost adjustments taken as deductions against invoices issued by the Company. In the apparel industry, these are commonly referred to as markdown allowances or chargebacks. Without a corresponding decrease in fabric and labor prices, these markdown allowances have led to a decline in wholesale gross margins. Management believes these modest deflationary pressures will persist into the foreseeable future.

Future Operating Results

Business conditions in the apparel sector continue to be characterized by limited consumer demand and persistent discounting of merchandise by retailers. The continuing conflict in Iraq, coupled with the propensity of consumers to seek on sale merchandise has sustained the use of significant discounting by most retailers to stimulate sales. In general, retailers have to sell more units in order to achieve sales equal to last year. The Company does not expect significant improvement in business conditions in the apparel sector for the upcoming fiscal year. Furthermore, the Company expects to incur significant expense related to internal controls documentation, testing and remediation requirements as mandated by Sarbanes-Oxley legislation with which the Company must be in compliance by August 31, 2007. In view of the market uncertainties and economic pressures facing the Company, management remains conservative in its approach to the remainder of the fiscal year.

ITEM 4. Controls and Procedures

(a) *Disclosure Controls and Procedures*. Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our chief executive and financial officer, as appropriate, to allow for timely decisions regarding required disclosure.

Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. The design of any system of controls is based in part upon a cost-benefit analysis and certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions. While our management does not believe that our controls will prevent all errors or all instances of fraud, our disclosure controls and procedures are designed to provide a reasonable assurance of achieving their objectives.

As required by Securities and Exchange Commission Rule 13a-15(b), we conducted an evaluation, under the supervision and with the participation of our chief executive and financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on such evaluation, our chief executive and financial officer originally concluded that, as of the end of such period, our disclosure controls and procedures were effective at that reasonable assurance level.

We have re-evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that re-evaluation, our chief executive and financial officer concluded that certain control deficiencies, as described below, existed in our internal control over financial reporting as of May 31, 2006. As a result of these deficiencies, our chief executive and financial officer has concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of May 31, 2006.

Notwithstanding the deficiencies described below, management believes the consolidated financial statements included in this Quarterly Report on Form 10-Q fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

Following our acquisition of Designer Intimates in October 2005, we integrated the accounting and financial operations and personnel from that company into our operations. We filed for an extension of time to complete the preparation of our Annual Report on Form 10-K for the year ended August 31, 2005, in part to reflect the results of that transaction. Thereafter we filed for an extension of time to complete the preparation of our Quarterly Reports on Form 10-Q for the periods ended November 30, 2005 and February 28, 2006. Subsequently, in June 2006 we entered into transactions for the purchase of the Home Décor business and the Saguaro brand. We then filed for an extension of time to file our Quarterly Report on Form 10-Q for the period ended May 31, 2006.

Inefficient allocation of staffing in our financial reporting functions. Following our acquisition of Designer Intimates, we anticipated an increase in the volume of financials transactions that we would process as a result of that transaction. During the period ended May 31, 2006, our chief execuive officer determined that the allocation of responsibilities and reporting structures within our accounting staff was inefficient. This inefficiency results in information dependency on a few key accounting personnel. As a result of these inefficiencies we were unable to timely complete our closing procedures for this Quarterly Report on Form 10-Q.

Our recent acquisitions will raise additional accounting treatment and disclosure issues, and our accounting staff does not have significant recent experience addressing the issues related to acquisitions. Our acquisitions of Home Décor and Saguaro will raise additional accounting issues and disclosure obligations. Those transactions, along with our recent acquisition of Designer Intimates will be the first acquisition transactions that we had completed in some time. In connection with those acquisitions, we will be required to conduct additional financial procedures, including valuation analysis and goodwill impairment testing. Our accounting staff has limited experience in completing these increasingly complex procedures.

We took some steps during the period following May 31, 2006 to remedy these deficiencies.

- We reassigned certain accounting duties and reporting responsibilities among our accounting staff.
- We retained a new accounts receivable manager.
- We worked with consultants to identify additional accounting issues that may arise in connection with our recent acquisitions.
- We procured education for some of our accounting staff in anticipation of the increasingly complex financial transaction reporting obligations.

The deficiency related to our staffing was not remedied as of May 31, 2006. We are continuing to reorganize our accounting functions and processes. We expect that this remediation may take one or two quarters to complete.

(b) *Changes In Internal Controls Over Financial Reporting.* Except as set forth above, no changes were made in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during our most recent fiscal quarter that has materially affected, or is likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 6. Exhibits

31.1 Certification required under Section 302

32.1 Certification required under Section 906

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

January 31, 2007

By: /s/ Steven P. Wyandt
Steven P. Wyandt
As Principal Financial Officer and on behalf of the Registrant

EXHIBIT INDEX

Exhibit Number	Exhibit
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