ADVANCED MATERIALS GROUP INC
Form 10-Q
July 16, 2001

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

/X/ QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934.

FOR THE QUARTERLY PERIOD ENDED MAY 31, 2001.
OR

/ / TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE EXCHANGE ACT

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NO. 0-16401

ADVANCED MATERIALS GROUP, INC.
(Exact name of small business issuer as specified in its charter)

NEVADA	33-0215295
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20211 S. SUSANA ROAD, RANCHO DOMINGUEZ, CALIFORNIA 90221
(Address of principal executive offices)

(310) 537-5444
Issuer's telephone number

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or 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. X Yes No

Indicate the number of shares outstanding of each of the issuer's class of common equity, as of the latest practicable date:

COMMON STOCK, $.001 PAR VALUE, 8,671,272 SHARES AS OF JULY 13, 2001.

ADVANCED MATERIALS GROUP, INC.
FORM 10-Q
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

(UNAUDITED)

PART I - FINANCIAL INFORMATION

ITEM I - CONSOLIDATED FINANCIAL STATEMENTS

ADVANCED MATERIALS GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	THREE MONTHS ENDED		
	MAY 31, 2001	MAY 28, 2000	M
Net sales	$ 9,955,000	$ 10,243,000	$
Cost of sales	8,874,000	8,655,000	
Gross profit	1,081,000	1,588,000	
Operating expenses:			
Selling, general and administrative	1,125,000	1,094,000	

Depreciation and amortization	90,000	67,000	
Restructuring costs	1,440,000	---	
Total operating expenses	2,655,000	1,161,000	
(Loss) Income from operations	(1,574,000)	427,000	
Other income (expense):			
Interest expense	(132,000)	(131,000)	
Foreign exchange gain (loss)	25,000	(10,000)	
Other, net	(28,000)	(20,000)	
Total other income and expenses	(135,000)	(161,000)	
(Loss) income before income taxes	(1,709,000)	266,000	
Income tax expense	(17,000)	----	
Net (loss) income	$ (1,726,000)	$ 266,000	$
Basic (loss) earnings per common share	$ (0.20)	$ 0.03	$
Diluted (loss) earnings per common share	$ (0.20)	$ 0.03	$
Basic weighted average common shares outstanding	8,671,272	8,589,555	
Diluted weighted average common shares outstanding	8,671,272	8,894,168	

See accompanying notes to consolidated financial statements

ADVANCED MATERIALS GROUP, INC.
CONSOLIDATED BALANCE SHEETS
MAY 31, 2001 AND NOVEMBER 30, 2000

ASSETS

	2001	2000
	(UNAUDITED)	
Current assets:		
Cash and cash equivalents	$ 735,000	$ 1,101,000
Accounts receivable, net	6,777,000	7,753,000
Inventories, net	3,649,000	4,962,000
Income tax receivable	32,000	32,000
Deferred income taxes	337,000	337,000
Prepaid expenses and other	363,000	364,000

Total current assets	11,893,000	14,549,000
Property and equipment, net	2,964,000	3,007,000
Goodwill, net	419,000	451,000
Deferred income taxes	206,000	206,000
Other assets	218,000	152,000
Total assets	$ 15,700,000	$ 18,365,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 4,588,000	$ 5,952,000
Accrued liabilities	1,190,000	1,210,000
Restructuring reserve,current	491,000	--
Deferred income	344,000	273,000
Line of credit	3,111,000	3,585,000
Current portion of long-term obligations	346,000	360,000
Total current liabilities	10,070,000	11,380,000
Term loan	886,000	892,000
Convertible debentures	405,000	405,000
Deferred compensation, net of current protion	1,056,000	1,056,000
Restructuring reserve, net of current portion	802,000	--
Capital leases, net of current portion	308,000	341,000
Total liabilities	13,527,000	14,074,000
Stockholders' equity:		
Preferred stock-$.001 par value; 5,000,000 shares authorized no shares issued and outstanding	--	--
Common stock-$.001 par value; 25,000,000 shares authorized; 8,671,272 shares issued and outstanding at May 31, 2001 and November 30, 2000, respectively	9,000	9,000
Additional paid-in capital	7,083,000	7,083,000
Accumulated deficit	(4,919,000)	(2,801,000)
Total stockholders' equity	2,173,000	4,291,000
Total liabilities and stockholders' equity	$ 15,700,000	$ 18,365,000

See accompanying notes to consolidated financial statements

4

ADVANCED MATERIALS GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	SIX MONTHS ENDED	
	MAY 31, 2001	MAY 28, 2000

Cash flows from operating activities:		
Net (loss) income	$(2,118,000)	$ 517,000
Adjustments to reconcile net(loss) income to net cash provided by operating activities		
Depreciation	406,000	492,000
Amortization	32,000	31,000
Provision for obsolete inventory	262,000	(28,000)
Discontinued operations	--	(10,000)
Interest on deferred compensation	78,000	71,000
Deferred income	71,000	(15,000)
Loss on disposal of fixed assets	15,000	--
Changes in operating assets and liabilities:		
Accounts receivable - trade	976,000	105,000
Inventories	1,051,000	(851,000)
Prepaid expenses and other	1,000	47,000
Accounts payable and accrued liabilities	(1,384,000)	33,000
Restructuring reserve	1,293,000	--
Net cash provided by operating activities	683,000	392,000
Cash flows from investing activities:		
Purchases of property and equipment	(378,000)	(490,000)
Increase in other assets	(66,000)	--
Amounts borrowed by affiliate	--	28,000
Net cash used in investing activities	(444,000)	(462,000)
Cash flows from financing activities:		
Net (repayments) borrowings under line of credit	(474,000)	393,000
Repayments of other long-term obligations	(131,000)	(166,000)
Proceeds received from capitalized financing	--	25,000
Exercise of common stock options	--	51,000
Net cash (used in) provided by financing activities	(605,000)	303,000
Net change in cash and cash equivalents	(366,000)	233,000
Cash and cash equivalents, beginning of period	1,101,000	496,000
Cash and cash equivalents, end of period	$ 735,000	$ 729,000
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$ 288,000	$ 243,000
Income taxes	$---	$---

See accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1) BASIS OF PRESENTATION

The accompanying condensed consolidated balance sheet at May 31, 2001, and the condensed consolidated statements of operations and cash flows for the three and six months ended May 31, 2001 and Mary 28, 2000 are unaudited and have been prepared by Advanced Materials Group, Inc. (the "Company"), pursuant to the rules and regulations of the Security and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures included herein are adequate to make the information presented not misleading. The unaudited condensed consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary to fairly state the consolidated financial position as of May 31, 2001, and the results of operations and cash flows for the related interim periods ended May 31, 2001 and May 28, 2000. The results of operations for the three and six months ended May 31, 2001 are not necessarily indicative of the results that may be expected for the year ending November 30, 2001 or any other period.

2) INVENTORIES

Inventories are stated at the lower of cost (determined on the first-in, first-out method) or market. Inventories consisted of the following:

	MAY 31, 2001	NOVEMBER 30, 2000
Raw Materials	$ 2,514,000	$ 3,091,000
Work-in-process	301,000	204,000
Finished Goods	1,252,000	1,823,000
	4,067,000	5,118,000
Less allowance for obsolete inventory	(418,000)	(156,000)
	$ 3,649,000	$ 4,962,000

3) BASIC AND DILUTED INCOME (LOSS) PER COMMON SHARE

Basic and Diluted income (loss) per share is computed in accordance with Statement of Financial Accounting Standards No. 128 ("SFAS No. 128"). In the May 31, 2001 computations, common equivalent shares are excluded from diluted loss per share as their effect is antidilutive. Basic and Diluted income (loss) for the three and six months ended May 31, 2001 and May 28, 2000 are as follows:

	THREE MONTHS ENDED		
	MAY 31, 2001	MAY 28, 2000	MAY 3

BASIC EPS:			
Net (loss) income	$(1,726,000)	$ 266,000	$(2,1
Denominator: Weighted average common shares outstanding	8,671,272	8,589,555	8,6
Net (loss) income per share (basic)	$ (0.20)	$ 0.03	$
DILUTED EPS:			
Net (loss) income	$(1,726,000)	$ 266,000	$(2,1
Denominator: Weighted average common shares outstanding	8,671,272	8,589,555	8,6
Common equivalent shares outstanding (options and warrants)	--	842,717	
Hypothetical shares repurchased at average market price with proceeds of exercise	--	(538,104)	
Total shares	8,671,272	8,894,168	8,6
Net (loss) income per share (diluted)	$ (0.20)	$ 0.03	$

4) SEGMENT REPORTING

The Company's foreign operations include both manufacturing and sales. The manufacturing facility is located in Ireland and the sales joint venture is located in Singapore. Both facilities began operations in fiscal 1998. All of the sales are made to unaffiliated customers. The following is a summary of selected financial information by entities within geographic areas for the second quarter and six months ended May 31, 2001 and May 28, 2000.

THREE MONTHS ENDED MAY 31, 2001 AND MAY 28, 2000

REVENUE:

	AMI-US OPERATIONS	AMI-SINGAPORE	AMI
2001....................................	$5,041,000	$2,738,000	$2,
2000....................................	$6,186,000	$2,599,000	$1,

NET INCOME (LOSS):

	AMI-US OPERATIONS	AMI-SINGAPORE	AMI
2001....................................	$(2,065,000)	$ 252,000	
2000....................................	$ (130,000)	$ 355,000	

SIX MONTHS ENDED MAY 31, 2001 AND MAY 28, 2000

REVENUE:

	AMI-US OPERATIONS	AMI-SINGAPORE	AMI
2001..................................	$10,394,000	$5,171,000	$4,
2000..................................	$11,853,000	$4,874,000	$2,

NET INCOME (LOSS):

	AMI-US OPERATIONS	AMI-SINGAPORE	AMI
2001..................................	$(2,783,000)	$ 462,000	$
2000..................................	$ (287,000)	$ 726,000	$

ASSETS: AS OF MAY 31, 2001 AND NOVEMBER 30, 2000

	AMI-US OPERATIONS	AMI-SINGAPORE	AMI
2001..................................	$ 8,968,000	$ 3,201,000	$ 3
2000..................................	$ 11,681,000	$ 3,648,000	$ 3

5) RESTRUCTURING CHARGES

The Company has announced the closure of its manufacturing facility in Dallas, Texas and its distribution centers in Portland, Oregan and Parker, Colorado which is expected to be completed by the end of fiscal year 2001. The Company is closing these facilities in order to consolidate its U.S. operations into its plant in California and reduce overhead costs in response to its lower domestic sales. A one-time restructuring charge of $1,440,000 was recorded in the second quarter of fiscal year 2001 relating to the plant closures. Approximately 20 employees will be terminated in conjuction with the closures and estimated serverance costs are approximately $135,000. The remainder of the restructuring charge consists of lease abandonment costs of approximately $1 million (net of probable sub-lease revenue of $250,000) which have been substantially classified as a long-term liability as payment will be made through November 2005.

6) CONTINGENT LIABILITIES

Legal proceedings to which the Company is a party are discussed in Part 1 Legal Proceedings, in the latest Annual Report on form 10-K.

7) DEBT

At May 31, 2001, the Company was not in compliance with minimum net income, minimum book net worth and debt service coverage ratio and therefore is in technical default under the compliance provisions of its bank line of credit. The Company is currently in discussions with the lender to amend the financial covenants. Although, management believes it will be successful with its discussions, there can be no assurance of this success or that management would be successful in finding a replacement lender with acceptable terms. In order to fund present and future operations, the Company needs to cure its covenant violations with its lender or find a replacement lender with acceptable terms. While the Company is in the process of attempting to cure its line of credit violations, and has initiated plans to return to profitability, there are no assurances that the Company will be successful in completing these critical tasks. If the Company is unable to successfully complete these critical tasks, it may be forced to reduce its operations and/or liquidate inventory at amounts below current carrying value to generate the necessary working capital to fund its operations.

8) RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement establishes account and reporting standards for derivative instruments and requires recognition of all derivatives as assets or liabilities in the statement of financial position and measure of those instruments at fair value. SFAS No. 133, as amended by SFAS No. 137, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. ADMG adopted the standard during the first quarter of fiscal year 2001. The Company currently does not engage in derivative or hedging activities, and accordingly, there has been no impact to its consolidated financial statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements ("SAB 101"). SAB 101 summarizes certain areas of the Staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. The Company believes that its current revenue recognition policies comply with SAB 101.

In March 2000, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions involving Stock Compensation." The adoption of this Interpretation did not have a material impact on the consolidated results of operations or financial position of the Company.

In November 2000, the Emerging Task Force ("EITF") issued EITF 00-27, "Application of Issue No. 98-5, "Accounting for Convertible Conversion Features or Contingently Adjustable Conversion Ratios to Certain Convertible Instruments".

The adoption of this EITF did not have a material impact on the consolidated results of operations or financial position of the Company.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF INTERIM FINANCIAL INFORMATION (UNAUDITED).

The following discussion should be read in conjunction with the consolidated financial statements and the related notes that appear elsewhere in this document.

This document contains forward-looking statements that involve risks and uncertainties that could cause the results of the Company and its consolidated subsidiaries to differ materially from those expressed or implied by such forward-looking statements. These risks include the timely development, production and delivery of new products; the challenge of managing asset levels, including inventory and trade receivables; the difficulty of keeping expense growth at modest levels while increasing revenues; and other risks described from time to time in the Company's filings with the Securities and Exchange Commission, including but not limited to the Annual Report on Form 10-K for the year ended November 30, 2000.

Forward-looking statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated or expected.

RESULTS OF OPERATIONS

FY 01 CURRENT THREE MONTHS VERSUS FY 00

Net revenue for the second quarter ended May 31, 2001 was $9,955,000,versus $10,243,000 for the same period of fiscal 2000, a decrease of 3%. The decrease in net revenues for the second quarter of fiscal 2001 is primarily attributable to lower domestic sales prices and volumes relating to the slowdown in domestice economic conditions.

Cost of sales for the second quarter ended May 31, 2001 and May 28, 2000 was $8,874,000 and $8,655,000, respectively. Cost of sales as a percentage of net revenue was 89% for the second quarter of fiscal 2001,compared to 84% for the second quarter of fiscal 2000. Cost of sales as a percentage of net revenue increased for the second quarter of fiscal 2001 compared to the second quarter of fiscal 2000. This increase is primarily due to inventory write offs relating to the closing of the Company's plant in Texas, lower domestic sales prices and a reduction in the Companies share of the gross profit per its agreement with its strategic manufacturing partner in Singapore.

Selling, general and administrative expenses for the second quarter of May 31, 2001 and May 28, 2000 was $1,125,000 and $1,094,000, respectively. The increase was due primarily to the Company's expansion in Ireland and unfavorable foreign currancy fluctuations in 2001 compared to 2000. The Company continues to focus on the reduction of operating expense ratios and optimization of manufacturing processes in order to improve profitability.

The Company has announced the closure of its manufacturing facility in Dallas, Texas and its distribution centers in Portland, Oregan and Parker, Colorado which is expected to be completed by the end of fiscal year 2001. The Company is closing these facilities in order to consolidate its U.S. operations into its plant in California and reduce overhead costs in response to its lower domestic sales. A one-time restructuring charge of $1,440,000 was recorded in the second quarter of fiscal year 2001 relating to the plant closures. Approximately 20 employees will be terminated in conjuction with the closures and estimated serverance costs are approximately $135,000. The remainder of the restructuring charge consists of lease abandonment costs of approximately $1 million (net of probable sub-lease revenue of $250,000) which have been substantially classified as a long-term liability as payment will be made through November 2005.

Interest expense for the second quarter of fiscal 2001and 2000 was $132,000 and $131,000, respectively.

Net loss for the second quarter of fiscal 2001 was $(1,726,000) and excluding restructuring charges net loss was $(286,000), compared to net income of $266,000 for the second quarter of 2000. Basic income (loss) per share for the second quarter of fiscal 2001 was $(0.20) per share on a weighted average of 8.7 million shares, compared to $0.03 on a weighted average of

8

8.6 million shares for the second quarter of fiscal 2000. Diluted loss per share for the second quarter of fiscal 2001 was $(0.20) per share on a weighted average of 8.7 million shares, compared to $0.03 on a weighted average of 8.9 million shares for the second quarter of fiscal year 2000.

FY 01 SIX MONTHS VERSUS FY 00

Net revenue for the six months ended May 31, 2001 was $19,904,000,versus $19,724,000 for the same period of fiscal 2000. Net revenues continue to slow due to domestic economic conditions.

Cost of sales for the six months ended May 31, 2001 and May 28, 2000 was $17,755,000 and $16,658,000, respectively. Cost of sales as a percentage of net revenue was 89% for the six months of fiscal 2001,compared to 84% for the six months of fiscal 2000. Cost of sales as a percentage of net revenue increased for the six months of fiscal 2001, compared to the six months of fiscal 2000. This increase is primarily due to inventory write offs relating to the closing of the Company's plant in Texas, lower domestic sales prices and a reduction in the Companies share of the gross profit per its agreement with its strategic manufacturing partner in Singapore.

Selling, general and administrative expenses for the six months of May 31, 2001 and May 28, 2000 was $2,294,000 and $2,145,000, respectively. The increase was due to Company's expansion in Ireland. The Company continues to focus on the reduction of operating expense ratios and optimization of manufacturing processes in order to improve profitability.

The Company has announced the closure of its manufacturing facility in Dallas, Texas and its distribution centers in Portland, Oregan and Parker, Colorado which is expected to be completed by the end of fiscal year 2001. The Company is closing these facilities in order to consolidate its U.S. operations into its plant in California and reduce overhead costs in response to its lower domestic sales. A one-time restructuring charge of $1,440,000 was recorded in the second quarter of fiscal year 2001 relating to the plant closures. Approximately 20 employees will be terminated in conjuction with the closures and estimated serverance costs are approximately $135,000. The remainder of the restructuring charge consists of lease abandonment costs of approximately $1 million (net of probable sub-lease revenue of $250,000) which have been classified as a long-term liability as payment will be made through November 2005.

Interest expense for the six months of fiscal 2001and 2000 was $292,000 and $250,000, respectively. Increase due to higher average loan balance in the first quarter.

Net loss for the six months of fiscal 2001 was $ (2,118,000) and excluding restructuring charges net loss was $(678,000), compared to net income of

$517,000 for the six months of 2000. Basic income (loss) per share for the second quarter of fiscal 2001 was $(0.24) per share on a weighted average of 8.7 million shares, compared to $0.06 on a weighted average of 8.6 million shares for the six months of fiscal 2000. Diluted loss per share for the six months of fiscal 2001 was $(0.24) per share on a weighted average of 8.7 million shares, compared to $0.06 on a weighted average of 8.9 million shares for the six months of fiscal 2000.

SEGMENT INFORMATION

The following is a discussion of operating results for each of the Company's business segments. Quarterly financial data for each segment can be found in Note 4 to these consolidated financial statements. The reportable segments disclosed in this Form 10-Q are based on the Company's internal management responsibility.

FY 01 CURRENT THREE MONTHS VERSUS FY 00

AMI-U.S. OPERATIONS

Net revenue for the second quarter ended May 31, 2001 was $5,041,000, compared to net revenue for the second quarter ended May 28, 2000 of $6,186,000. Net loss for the second quarter ended May 31, 2001 was $(2,314,000), excluding restructuring charges net loss was $(624,000), compared to net loss for the second quarter of ended May 31, 2000 of $(130,000). The increase in net loss is primarily attributable to lower net revenue volumes coupled with fixed manufacturing costs.

9

AMFSC-SINGAPORE

Net revenue for the second quarter ended May 31, 2001 was $2,738,000, compared to net revenue for the second quarter ended May 28, 2000 of $2,599,000. The increase in net revenues for the second quarter of fiscal 2000 is primarily attributable to higher volumes of component sales to computer printer manufacturers. Printer supply sales to key customer accounts have reflected continued growth in the installed base, growth in printing from the Internet and increased usage of newly introduced products. Net income for the second quarter ended May 31, 2001 was $252,000, compared to net income for the second quarter ended May 28, 2000 of $355,000. Decrease in net income is primarily attributable to the gross profit sharing agreement with the Company's strategic manufacturing partner in Singapore.

AML-IRELAND

Net revenue for the second quarter ended May 31, 2001 was $2,176,000, compared to net revenue for the second quarter ended May 28, 2000 of $1,458,000. The increase in net revenues for the second quarter of fiscal 2001 is primarily attributable to higher volumes of component sales to computer printer manufacturers. Printer supply sales to key customer accounts reflected continued growth in the installed base, growth in printing from the Internet and increased usage of newly introduced products. Net income for the second quarter ended May 31, 2001 was $87,000, compared to net income for the second quarter ended May 28, 2000 of $41,000.

FY 01 SIX MONTHS VERSUS FY 00

AMI-U.S. OPERATIONS

Net revenue for the six months ended May 31, 2001 was $10,394,000, compared to net revenue for the six months ended May 28, 2000 of $11,853,000. Net loss for the six months ended May 31, 2001 was $(3,033,000), excluding restructuring charges net loss was $(1,343,000), compared to net loss for the six months ended May 31, 2000 of $(287,000). The increase in net loss excluding restructuring charges is primarily attributable to lower net revenue volumes coupled with fixed manufacturing costs.

AMFSC-SINGAPORE

Net revenue for the six months ended May 31, 2001 was $5,171,000, compared to net revenue for the six months ended May 28, 2000 of $4,874,000. The increase in net revenues for the six months of fiscal 2001 is primarily attributable to higher volumes of component sales to computer printer manufacturers. Printer supply sales to key customer accounts will reflect continued growth in the installed base, growth in printing from the Internet and increased usage of newly introduced products. Net income for the six months ended May 31, 2001 was $462,000, compared to net income for the six months ended May 28, 2000 of $726,000. Decrease in net income is primarily attributable to the gross profit sharing agreement with the Company's strategic manufacturing partner in Singapore.

AML-IRELAND

Net revenue for the six months ended May 31, 2001 was $4,339,000, compared to net revenue for the six months ended May 28, 2000 of $2,997,000. The increase in net revenues for the six months of fiscal 2001 is primarily attributable to higher volumes of component sales to computer printer manufacturers. Printer supply sales to key customer accounts reflected continued growth in the installed base, growth in printing from the Internet and increased usage of newly introduced products. Net income for the six months ended May 31, 2001 was $203,000, compared to net income for the six months ended May 28, 2000 of $78,000. Increase is primarily due to higher sales volume.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were $735,000 at May 31, 2001, compared with $1,101,000 at November 30, 2000. During the second quarter cash flows from operating activities were used to pay down short- and long-term debt and purchase property, plant and equipment.

Operating activities generated $683,000 of cash during the second quarter fiscal 2001, compared with $392,000 in the corresponding period in fiscal 2000. The increase in cash generated from operating activities in fiscal 2001 resulted primarily from operations and a decrease in accounts receivables.

Inventory at May 31, 2001 was $3,649,000, compared to $4,962,000 at November 30, 2000. Inventory levels decreased primarily due to an anticipated short-term reduction in the domestic sales volume.

Net trade receivables at May 31, 2001 were $6,777,000, compared to $7,753,000 at

November 30, 2000. The decrease is due to reduction in domestic net revenues.

Capital expenditures were $378,000 for the second quarter of fiscal 2001, compared to $462,000 for the corresponding period in fiscal 2000. The Company has instituted a Company-wide program to reduce non-essential capital expenditures, which are not specifically focused on revenue growth.

The Company uses short- and long-term borrowings to supplement internally generated cash flow. Short- and long-term borrowings in the second quarter of fiscal 2001 decreased by $480,000.

The Company had $735,000 of cash and cash equivalents at May 31, 2001. The Company has a $5,000,000 operating credit line with its primary lenders with approximately $2,795,000 currently outstanding as of June 15, 2001, which expires in February 2002. The Company has an outstanding term loan of $886,000 as of May 31, 2001 with the same bank. The term loan bears interest at prime plus 1.25% and libor plus 1.0% (8.25% and 6.5% at May 31, 2001). The Company anticipates that existing cash, cash from operations and existing lines of credit will supply sufficient cash for its short and long term projected needs for operations as long as the Company is successful in curing its covenant violations or finding a replacement lender with acceptable terms. (See discussion below).

At May 31, 2001, the Company was not in compliance with minimum net income, minimum book net worth and debt service coverage ratio and therefore is in technical default under the compliance provisions of its bank line of credit. The Company is currently in discussions with the lender to amend the financial covenants. Although, management believes it will be successful with its discussions, there can be no assurance of this success or that management would be successful in finding a replacement lender with acceptable terms. In order to fund present and future operations, the Company needs to cure its covenant violations with its lender or find a replacement lender with acceptable terms. While the Company is in the process of attempting to cure its line of credit violations, and has initiated plans to return to profitability, there are no assurances that the Company will be successful in completing these critical tasks. If the Company is unable to successfully complete these critical tasks, it may be forced to reduce its operations and/or liquidate inventory at amounts below current carrying value to generate the necessary working capital to fund its operations.

FACTORS THAT COULD AFFECT FUTURE RESULTS

Competition - We encounter aggressive competition in all areas of our business. We have numerous competitors, ranging from several comparable-size companies to many relatively small companies. The majority of our competitors are private, closely held companies. We compete primarily on the basis of performance, price, quality and customer service. Product life cycles are short, with numerous small one-time customer orders. To remain competitive, the Company must be able to quickly develop new products and enhance existing products in response to customer demands. In particular, management anticipates a continuing need to lower the prices of many of the Company's products to stay competitive and effectively manage financial returns with resulting reduced gross margins. In some of our markets, we may not be able to successfully compete against current and future competitors, and the competitive pressures we face could harm our business and prospects.

New Product Introductions - If the Company cannot continue to rapidly develop and manufacture innovative products that meet customer requirements for performance, price, quality and customer service, we may lose market share and future revenue and earnings may suffer. The process of developing new products and corresponding manufacturing processes is complex and uncertain. The customer decision-making process can be lengthy and some raw materials have extremely long lead times. These circumstances often lead to long delays in new product introductions. After a product is developed, we must be able to manufacture sufficient volumes quickly at low enough costs. To do this we must accurately forecast volumes and mix of products. Customer orders have also been subject to dramatic swings from customer provided forecasts. Thus,

matching customers' demand and timing for particular products makes the process of planning production and managing inventory levels increasingly difficult.

Short Product Life Cycles - The short life cycles of many of the Company's products pose a challenge for us to manage effectively the transition from existing products to new products. If we do not manage the transition effectively, our future revenue and earnings could suffer. Among the factors that make a smooth transition from current products to new products difficult are delays in the customer decision-making process, development of manufacturing processes, long lead times for the delivery of raw materials and variations in product costs. Our future revenues and earnings could also suffer due to the timing and introduction of new product offerings, which compete directly or indirectly with our customers' products and new product offerings by our competitors.

Reliance on Suppliers - The Company's manufacturing operations depend on our suppliers' ability to deliver quality raw materials and components in time for us to meet critical manufacturing and distribution schedules. We sometimes experience a short supply of certain raw materials as a result of supplier out-of-stock situations or long manufacturing lead times. If shortages or delays exist, the Company's future operating results could suffer. Furthermore, we may not be able to secure enough raw materials at reasonable prices to manufacture new products in the quantities required to meet customer demand. Sudden or large raw materials price increases could also cause future operating results to suffer.

International - Sales outside the United States make up more than 46% of the Company's revenues. Manufacturing for these products are also located outside of the United States. The Company's future earnings or financial position could be adversely affected by a variety of international factors, including:

- Changes in a country or region's political or economic conditions,
- Trade protection measures,
- Import or export licensing requirements,
- The overlap of different tax structures,
- Unexpected changes in regulatory requirements,
- Problems caused by the conversion of various European currencies to the Euro, and
- Natural disasters.

Market Risk - The majority of the Company's sales are denominated in U.S. dollars. All costs in Singapore and the majority of direct material costs in Ireland are also denominated in U.S. dollars. However, the Company is exposed to foreign currency exchange risk inherent in our sales commitments, anticipated sales and assets and liabilities denominated in currencies other than the U.S. dollar. See also "Item 7A. Quantitative and Qualitative Disclosures About Market Risk" in the Company's 1999 Annual Report on Form 10-K for more detailed information.

Earthquake - Our corporate offices and manufacturing division in California are located near major earthquake faults. The ultimate impact on the Company and our general infrastructure is unknown, but operating results could be materially affected in the event of a major earthquake. We are predominantly uninsured for losses and interruptions caused by earthquakes.

Environmental - Some of the Company's operations use substances regulated under various federal, state and international laws governing the environment. It is our policy to apply strict standards for environmental protection to sites inside and outside the U.S., even when not subject to local government regulations.

Profit Margin - The Company's profit margins vary somewhat among our products and geographic markets. Consequently, our overall profitability in any given period is partially dependent on the product, customer and geographic mix reflected in that period's net revenue.

Stock Price - The Company's stock price, like that of any other small-cap company, can be volatile. Some of the factors that can affect our stock price are:

- The Company's, our customer's or our competitor's announcement of new or discontinued products,
- Quarterly increases or decreases of our earnings,
- Changes in revenue or earnings estimates by the investment community, and
- Speculation in the press or investment community.

12

General market conditions and domestic or international macroeconomic factors unrelated to the Company's performance may also affect our stock price. For these reasons, investors should not rely on recent trends to predict future stock prices or financial results. In addition, following periods of volatility in a company's securities, securities class action litigation against a company is sometimes instituted. This type of litigation could result in substantial costs and the diversion of management time and resources.

Earnings Fluctuations - Although management believes the Company has products and resources needed for successful results, we cannot reliably predict future revenue and margin trends. Actual trends may cause us to adjust our operations, which could cause period-to-period fluctuations in our earnings.

The Company's common stock traded on the NASDAQ Small-Cap Stock Market ("NASDAQ") under the symbol "ADMG" from June 23, 1993 until December 13, 2000. Effective as December 14, 2000, the Company's common stock was delisted from the NASDAQ and has traded on the NASD-regulated OTC Bulletin Board ("Bulletin Board") under the symbol "ADMG.OB." The high and low closing prices for the common stock for the past two fiscal years as reported by NASDAQ and the Bulletin Board are set forth in the forth in the following table. Such quotations reflect inter-dealer prices, without retail mark-up, markdown or commission, and may not represent actual transactions.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

A discussion of the Company's exposure to, and management of, market risk appears in Item 2 of this Form 10-Q under the heading "Factors That Could Affect Future Results."

PART II - OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company held its Annual Meeting of Shareholders (the "Annual Meeting") on May 23, 2001. At the Annual Meeting, the Company's shareholders elected Timothy R. Busch, Steve F. Scott, N. Price Paschall, Dr. Michael Ledeen, and Maurice J. DeWald to the Company's Board of Directors and approved the ratification of BDO Seidman LLP to serve as the Company's independent accountants for fiscal 2001. Proxies were solicited by the Company pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended. As of March 26, 2001, the record date for the Annual Meeting, there were approximately 8,671,272 shares of the Company's Common Stock outstanding, of which 5,901,259 shares, or 68% were present in person or by proxy at the Annual Meeting.

The following matters were brought before the Annual Meeting:

1) Election of Directors. Each of the following persons was elected as a director of the Company, to serve until the next Annual Meeting if the Company's shareholders and until his successor has been selected and qualified or until his resignation or removal with no abstentions or broker non-votes:

	VOTES FOR	VOTES AGAINST
Timothy R. Busch............................	5,584,010	317,249
Steve F. Scott..............................	5,584,037	317,222
N. Price Paschall...........................	5,584,037	317,222
Dr. Michael Ledeen..........................	5,584,037	317,222
Maurice DeWald..............................	5,584,037	317,222

2) Ratification of Selection of Accountants. The selection of BDO Seidman LLP as the Company's independent accountants for the fiscal year ending November 30, 2001 was voted on and ratified by the Company's stockholders as follows:

VOTES FOR	VOTES AGAINST	VOTES ABSTAINING
5,678,733	192,411	30,014

13

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits.

None

(b) Reports on Form 8-K

No reported 8-K developments submitted in quarter.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: July 13, 2001

ADVANCED MATERIALS GROUP INC.

By: /s/ STEVE F. SCOTT

Steve F. Scott
President and CEO
(Chief Executive Officer)

/s/ GAYLE ARNOLD

Gayle Arnold
Vice President
(Chief Financial Officer)
(Principal Financial and Accounting Officer)