ADVANCED MATERIALS GROUP INC
Form 10-Q
May 17, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended February 29, 2004

or

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

For the transition period from to

Commission File No. 0-16401

ADVANCED MATERIALS GROUP, INC.

(Exact name of registrant 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
(Registrant s telephone number, including area code)

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 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 ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in rule 12b-2 of the Exchange Act.) Yes ý No o

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, 9,920,787 SHARES OUTSTANDING AS OF FEBRUARY 29, 2004.

ADVANCED MATERIALS GROUP, INC.

FORM 10-Q

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PART I - FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

ADVANCED MATERIALS GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended			
		February 29, 2004		February 28, 2003
Net sales	$	2,015,000	$	5,293,000
Cost of sales		1,585,000		4,793,000
Gross profit		430,000		500,000
Operating expenses:				
Selling, general and administrative		397,000		499,000
Depreciation and amortization		50,000		53,000
Total operating expenses		447,000		552,000
Loss from operations		(17,000)		(52,000)
Other income (expense):				
Interest expense		(23,000)		(93,000)
Other, net		13,000		(27,000)
Total other expenses, net		(10,000)		(120,000)
Loss from continuing operations before income taxes		(27,000)		(172,000)
Income tax expense		42,000		
Loss from continuing operations		(69,000)		(172,000)
Income from discontinued operations				156,000
Net loss	$	(69,000)	$	(16,000)
Basic and diluted loss per common share:				
Loss from continuing operations	$	(0.01)	$	(0.02)
Income from discontinued operations				0.02
Net loss per share	$	(0.01)	$	0.00
Basic and diluted weighted average common shares outstanding		9,226,829		8,671,272

See accompanying notes to condensed consolidated financial statements

ADVANCED MATERIALS GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

		February 29, 2004		November 30, 2003 (A)
ASSETS				
Current assets:				
Cash and cash equivalents	$	14,000	$	21,000
Restricted cash				60,000
Accounts receivable, net of allowance of $31,000 and $54,000 at February 29, 2004 and November 30, 2003, respectively		1,257,000		1,319,000
Inventories, net		920,000		939,000
Prepaid expenses and other		106,000		161,000
Total current assets		2,297,000		2,500,000
Property and equipment, net		957,000		1,059,000
Other assets		48,000		48,000
Total assets	$	3,302,000	$	3,607,000
LIABILITIES AND STOCKHOLDERS DEFICIT				
Current liabilities:				
Bank overdraft	$	204,000	$	
Accounts payable		972,000		1,181,000
Accrued liabilities		425,000		439,000
Restructuring reserve, current		29,000		56,000
Line of credit		305,000		609,000
Convertible debentures		10,000		405,000
Term loan		338,000		361,000
Current portion of long-term obligations		347,000		360,000
Total current liabilities		2,630,000		3,411,000
Deferred compensation, net of current protion		951,000		951,000
Restructuring reserve, net of current portion		93,000		76,000
Other		48,000		57,000
Total liabilities		3,722,000		4,495,000
Commitments and contingencies				
Stockholders deficit:				
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; 9,920,787 and 8,671,272 shares issued and outstanding at February 29, 2004 and November 30, 2003, respectively		10,000		9,000
Additional paid-in capital		7,660,000		7,124,000
Accumulated deficit		(8,090,000)		(8,021,000)

Total stockholders deficit		(420,000)		(888,000)
Total liabilities and stockholders deficit	$	3,302,000	$	3,607,000

(A) Derived from the November 30, 2003 audited financial statements.

See accompanying notes to condensed consolidated financial statements

ADVANCED MATERIALS GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended	
	February 29, 2004	**February 28, 2003**
Cash flows from continuing operating activities:		
Net loss from continuing operations	$ (69,000)	$ (172,000)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	103,000	133,000
Provision for obsolete inventory	(22,000)	
Non-cash compensation	30,000	
Interest on deferred compensation		37,000
Changes in operating assets and liabilities:		
Accounts receivable	62,000	173,000
Inventories	41,000	52,000
Prepaid expenses and other	55,000	(118,000)
Accounts payable and accrued liabilities	(223,000)	(1,102,000)
Restructuring reserve	(10,000)	(112,000)
Deferred income		58,000
Net cash used in operating activities	(33,000)	(1,051,000)
Cash flows from investing activities:		
Purchases of property and equipment	(1,000)	(14,000)
Net cash used in investing activities	(1,000)	(14,000)
Cash flows from financing activities:		
Sale of common stock	500,000	
Exercise of common stock options	7,000	
Net repayments under line of credit	(304,000)	(963,000)
Net repayments under term loan	(23,000)	(33,000)
Repayment of convertible debentures	(395,000)	
Repayments of other long-term obligations	(22,000)	(78,000)
Increase in bank overdraft	204,000	
Net cash used in financing activities	(33,000)	(1,074,000)
Net change in cash and cash equivalents	(67,000)	(2,139,000)
Cash provided by discontinued operations		2,016,000
Cash and cash equivalents, beginning of period	81,000	157,000
Cash and cash equivalents, end of period	$ 14,000	$ 34,000
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$ 23,000	$ 93,000

Income taxes	$	$

See accompanying notes to condensed consolidated financial statements

ADVANCED MATERIALS GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1) BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission and therefore do not include all information and footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America.

The unaudited condensed consolidated financial statements do, however, reflect all adjustments, consisting of only normal recurring adjustments, which are, in the opinion of management, necessary to state fairly the financial position as of February 29, 2004 and November 30, 2003 and the results of operations and cash flows for the related interim periods ended February 29, 2004 and 2003. However, these results are not necessarily indicative of results for any other interim period or for the year. It is suggested that the accompanying condensed consolidated financial statements be read in conjunction with the Company s audited consolidated financial statements and accompanying notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended November 30, 2003.

The Company s consolidated financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred continued net losses and at February 29, 2004, the Company has working capital and stockholders deficits and is not in compliance with certain financial covenant ratios pertaining to its line of credit, and therefore is in technical default under the compliance provisions of the line of credit and term loan. The Company is in the process of attempting to cure its line of credit and term loan violations. Management has implemented a plan to reduce expenses and improve sales. The Company has altered its focus in the last few months and will now be concentrating on securing proprietary products primarily for the medical and consumer industry. The objective is to create advanced designs, using current materials. These products will be pursued through aggressive product development and the licensing of existing patented products or technology. These new products are expected to have higher profit margins and be less subject to competition. There can be 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 significantly reduce, restructure or cease its operations and/or liquidate inventory at amounts below current carrying value to generate the necessary working capital to fund its operations, and if necessary, seek other remedies available to the Company including protection under the bankruptcy laws.

These factors, among others, raise substantial doubt about the Company s ability to continue as a going concern. Our independent auditors, BDO Seidman, LLP, indicated in their report on the 2003 consolidated financial statements, that there is substantial doubt about our ability to continue as a going concern.

The condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

2) SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of Advanced Materials Group, Inc. and its wholly owned subsidiary, Advanced Materials, Inc. and Advanced Materials, Ltd. All significant intercompany accounts and transactions have been eliminated.

Reclassifications

Certain fiscal 2003 amounts in the accompanying condensed consolidated financial statements have been reclassified to conform to the fiscal 2004 presentation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Cash and Cash Equivalents

The Company considers highly liquid investments with a remaining maturity of three months or less when purchased to be cash equivalents. The Company s cash equivalents at February 29, 2004 consist primarily of investments in a money market fund.

Fair Value of Financial Instruments

The Company s cash and cash equivalents, accounts receivable, accounts payable and line of credit approximated fair value at February 29, 2004 because of the relatively short maturity of these instruments. The carrying value of debt approximated fair value at February 29, 2004 due to the Company s ability to obtain financing at similar interest rates from other lenders.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market. Cost includes raw materials, labor, manufacturing overhead and purchased products. Market is determined by comparison with recent purchases or net realizable value. Net realizable value is based on forecasts for sales of the Company s products in the ensuing years. Should demand for the Company s products prove to be significantly less than anticipated, the ultimate realizable value of the Company s inventories could be substantially less than the amount shown on the accompanying consolidated balance sheets.

Property and Equipment

Property and equipment are stated at cost. Expenditures for additions and major improvements are capitalized. Repairs and maintenance costs are charged to operations as incurred. When property and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts, and gains or losses from retirements and dispositions are credited or charged to operations.

Depreciation and amortization are computed using the straight-line method over estimated useful lives of five to seven years. Leasehold improvements are being amortized on a straight-line basis over the lesser of the useful life of the related improvements or term of the lease. Depreciation and amortization expense was approximately $103,000 and $133,000 for the three-month periods ended February 29, 2004 and February 28, 2003, respectively, of which $53,000 and $80,000, respectively, is included in cost of sales in the accompanying condensed consolidated statements of operations.

Impairment of Long-Lived Assets

Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets provides a single accounting model for long-lived assets to be disposed of. SFAS No. 144 also changes the criteria for classifying an asset as held for sale, and broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations and changes the timing of recognizing losses on such operations.

The Company adopted SFAS No. 144 on December 1, 2001. The adoption of SFAS No.144 did not affect the Company s financial statements. In accordance with SFAS No. 144, long-lived assets, such as furniture, fixtures and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, and impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Prior to the adoption of SFAS No. 144, the Company accounted for long-lived assets to be disposed of in accordance with SFAS No. 121, Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of.

Revenue Recognition

The Company recognizes revenue from product sales when it is realized or realizable and earned, which is generally at the time of shipment and passage of title. Revenue is considered to be realized or realizable and earned when there is persuasive evidence of a sales arrangement in the form of a contract or a purchase order, the product has been shipped, the sales price is fixed or determinable and collectibility is reasonably assured. The Company records revenue for shipping costs charged to customers. The related shipping costs incurred are recorded in cost of sales.

Environmental Remediation

Environmental expenditures that relate to current operations are expensed. Expenditures that relate to an existing condition caused by past operations, and which do not contribute to current or future revenue generation, are expensed. Liabilities are recorded when environmental assessments and/or remedial efforts are probable and the costs can be reasonably estimated. As of February 29, 2004 and November 30, 2003, no liabilities have been recorded.

Advertising Costs

Advertising costs are expensed as incurred. There were no advertising costs for the three-month periods ended February 29, 2004 and February 28, 2003.

Concentrations of Credit Risk

Cash and Cash Equivalents

At February 29, 2004, the Company maintained cash balances at certain financial institutions in excess of federally insured limits.

Customers

One customer, Hewlett Packard, accounted for 70% of consolidated sales for the three-month period ended February 28, 2003. These sales to Hewlett Packard were primarily through the Company s manufacturing agreement with its joint venture partner in Singapore. Sales to Hewlett Packard, Singapore aggregated 51% of consolidated sales for the three-month period ended February 28, 2003. Due to an amendment in the agreement in July 2003, the Company no longer sells directly to Hewlett Packard, but rather receives a percentage of the profit from its joint venture partner. Additionally, sales to Hewlett Packard, Puerto Rico accounted for 19% of consolidated sales for the three-month period ended February 28, 2003. Beginning in late 2003, the Company ceased selling to Hewlett Packard, Puerto Rico due to low gross margins. These changes significantly reduced the Company s percentage of sales accounted for by Hewlett Packard and Hewlett Packard is no longer a significant customer.

Suppliers

Foamex International, Inc. (Foamex) accounted for 14% and 43% of consolidated purchases for the three-month periods ended February 29, 2004 and February 28, 2003, respectively. Management believes that the loss of Foamex as a major supplier of foam could adversely affect the Company s business. If another supplier s products were to be substituted by our customers in critical applications, there are no assurances that the Company would retain the favorable supply position that it has earned through over 25 years as an authorized converter/fabricator for Foamex and Voltek.

The Company formed Advanced Materials Foreign Sales Corporation Ltd., a wholly-owned subsidiary of the Company, to enter into a strategic manufacturing agreement in Singapore. The Company entered into a ten-year agreement with Foamex Asia in January 1998. Terms of the agreement call for the Company to lease production equipment and provide certain technology to Foamex Asia. Foamex Asia will in turn provide its manufacturing facilities and workforce to fabricate foam products at Foamex Asia s Singapore facility. The manufacturing agreement has a profit sharing provision that changes annually. The profit sharing split is as follows (in percentages):

Year	The Company	Foamex
1998	65	35
1999	60	40
2000	50	50
2001	50	50
2002	45	55
2003	40	60
2004 2007	35	65

On June 20, 2003, the Company signed an amendment to its manufacturing agreement in Singapore with Foamex Asia to change the vendor of record for the customer supplied under the agreement from the Company to Foamex Asia. Although this change will not affect the Company s share of the profitability under the agreement, it will cause a significant reduction in its future reported revenues. Previously, the Company purchased the raw materials for the production of product and billed the end customer and therefore recognized the gross sales and cost of sales on its financials. Under the amended agreement, it will no longer purchase the raw materials or bill the end customer and will only recognize its portion of profit as revenue. The president of Foamex Asia is former employee of the Company to whom the Company was paying retirement benefits until March of 2003. The Company is currently involved in litigation with the former employee in regards to these payments.

Revenues as reported relating to the Singapore manufacturing agreement were $192,000 and $2,265,000 for the three-month periods ended February 29, 2004 and February 28, 2003, respectively. Under the amended agreement, only the Company s share of the profit is reported as revenue. The profits distributed to the Company pursuant to the Singapore manufacturing agreement were $192,000 and $197,000 for the three-month periods ended February 29, 2004 and February 28, 2003, respectively.

Risks and Uncertainties

Environmental Regulation and Operating Considerations

The manufacture of certain products by the Company requires the purchase and use of chemicals and other materials, which are or may be, classified as hazardous substances. The Company and its subsidiaries do not maintain environmental impairment insurance. There can be no assurance that the Company and its subsidiaries will not incur environmental liability or that hazardous substances are not or will not be present at their facilities.

The Company is subject to regulations administered by the United States Environmental Protection Agency, various state agencies, county and local authorities acting in conjunction with federal and state agencies. Among other things, these regulatory bodies impose restrictions to control air, soil and water pollution. The extensive regulatory framework imposes significant complications, burdens and risks on the Company. Governmental authorities have the power to enforce compliance with these regulations and to obtain injunctions and/or impose civil and criminal fines or sanctions in the case of violations.

The Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA), imposes strict joint and several liability on the present and former owners and operators of facilities which release hazardous substances into the environment. The Federal Resource Conservation and Recovery Act of 1976, as amended (RCRA), regulates the generation, governed by the law, which contains the California counterparts of CERCLA and RCRA. The Company believes that its manufacturing activities are in substantial compliance with all material Federal and state laws and regulations governing its operations. Amendments to existing statutes and regulations could require the Company to modify or alter methods of operations at costs, which could be substantial. There can be no assurance that the Company will be able, for financial or other reasons, to comply with applicable laws and regulations.

The Company believes that it currently conducts, and in the past has conducted, its activities and operations in substantial compliance with applicable environmental laws, and believes that costs arising from existing environmental laws will not have a material adverse effect on the Company s consolidated financial condition or results of operations. There can be no assurance, however, that environmental laws will not become more stringent in the future or that the Company will not incur costs in the future in order to comply with such laws.

Various laws and regulations relating to safe working conditions, including the Occupational Safety and Health Act (OSHA), are also applicable to the Company and its subsidiaries. The Company believes it and its subsidiaries are in substantial compliance with all material Federal, state and local laws and regulations regarding safe working conditions.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109). Under the asset and liability method of SFAS 109, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates expected to apply when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to amounts, which are more likely than not to be realized. The provision for income taxes is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

Loss Per Share

The Company has adopted the provisions of Statement of Financial Accounting Standards No. 128, Earnings per Share (SFAS 128). SFAS 128 requires the presentation of basic and diluted net income per share. Basic earnings per share exclude dilution and are computed by dividing net income by the weighted average of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. Potential common shares including stock options and convertible debentures have been excluded for the three-month periods ended February 29, 2004 and February 28, 2003, as their effect would be antidilutive.

There were 2,423,500 and 1,797,000 potentially dilutive options, exclusive of effect of convertible debentures, outstanding at February 29, 2004 and February 28, 2003, respectively, that were not included in the computation of the net loss per share because they would be anti-dilutive.

Stock Based Compensation

In December 2002, the FASB issued FAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure , which amended FAS No. 123, Accounting for Stock-Based Compensation. The new standard provides alternative methods of transition for a voluntary change to the fair market value based method for accounting for stock-based employee compensation. Additionally, the statement amends the disclosure requirements of FAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. In compliance with FAS No. 148, the Company has elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation plan as defined by APB No. 25.

The following table represents the effect on net income and earnings per share if the Company had applied the fair value based method and recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation , to stock-based employee compensation. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options vesting period. The Company s pro forma information follows:

	Three Months Ended	
	February 29, 2004	February 28, 2003
Net loss available to common shareholders	$ (69,000)	$ (16,000)
Plus: Stock-based employee compensation expense included in reported net loss		
Less: Total stock-based employee compensation determined using fair value based method	(41,000)	(13,000)
Pro forma net loss available to common stockholders	$ (110,000)	$ (29,000)
Net loss per common share - basic and diluted - as reported	$ (0.01)	$ (0.00)
Net loss per common share basic and diluted - pro forma	$ (0.01)	$ (0.00)

3) INVENTORIES

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

	February 29, 2004 (unaudited)	November 30, 2003
Raw Materials	$ 501,000	$ 532,000
Work-in-process	143,000	129,000
Finished Goods	335,000	359,000
	979,000	1,020,000
Less allowance for obsolete inventory	(59,000)	(81,000)
	$ 920,000	$ 939,000

4) STOCKHOLDERS DEFICIT

The following table summarizes changes in equity components from transactions during the three months ended February 29, 2004:

	Common Stock		Additional Paid-In Capital	Accumulated Deficit
	Shares	Amount		
Balance as of December 1, 2003	8,671,272	$ 9,000	$ 7,124,000	$ 8,021,000
Stock sold in private placement	1,219,515	1,000	499,000	
Exercise of common stock options	30,000		7,000	
Non-cash compensation			30,000	
Net loss for the period				69,000
Balance as of February 29, 2004	9,920,787	$ 10,000	$ 7,660,000	$ 8,090,000

The following table summarizes information about stock option activity during the three months ended February 29, 2004:

	Number of Options	Weighted Average Exercise Price
Outstanding December 1, 2003	2,343,500	
Canceled/expired	(30,000)	$ 1.19
Exercised	(30,000)	$ 0.22
Granted	140,000	$ 0.40
Outstanding February 29, 2004	2,423,500	$ 1.02
Exercisable at February 29, 2004	729,930	$ 1.05

Options outstanding are exercisable at prices ranging from $0.17 to $3.69 and expire over the period from January 19, 2005 to January 19, 2014 with an average life of 4.5 years.

In January 2004, the Company sold 1,219,515 shares of its common stock in a private equity placement for $500,000. The shares were sold to parties close to the Company, including its Chairman and its CEO, who were already major shareholders. There was no agent for the transaction. Proceeds from the sale were used to pay off existing vendors and for general working capital purposes.

5) SEGMENT REPORTING

The Company s foreign operations consist of a sales joint venture located in Singapore which 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 three months ended February 29, 2004 and February 28, 2003. On October 31, 2003, the Company sold its wholly-owned subsidiary in Ireland, Advanced Materials, Ltd. (AML-Ireland). Operating results of AML-Ireland for the three-month period ended February 28, 2003 are shown separately in the accompanying condensed consolidated statement of operations. Income from discontinued operations is included in the amounts for AMG-US Operations.

	US Operations	Singapore	Consolidated
Revenue:			
2004	$ 1,823,000	$ 192,000	$ 2,015,000
2003	$ 3,028,000	$ 2,265,000	$ 5,293,000
Segment Income (Loss):			
2004	$ (261,000)	$ 192,000	$ (69,000)
2003	$ (213,000)	$ 197,000	$ (16,000)
Corporate Allocation (1):			
2004	$	$	$
2003	$ (156,000)	$ 156,000	$
Net Income (Loss):			
2004	$ (261,000)	$ 192,000	$ (69,000)
2003	$ (57,000)	$ 41,000	$ (16,000)
Total Assets: As of February 29, 2004 and November 30, 2003			
2004	$ 3,292,000	$ 10,000	$ 3,302,000

2003	$ 3,597,000	$ 10,000	$ 3,607,000

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(1) Corporate allocation represents amounts allocated for general corporate expenses including costs for management, professional services, insurance and interest.

6) CONTINGENT LIABILITIES

Material legal proceedings to which the Company is a party are discussed in Part 1, Item 3, in the Company s latest Annual Report on Form 10-K and in Part II, Item 1 of this Form 10-Q.

7) LINE OF CREDIT

In October 2003, the Company entered into a new line of credit agreement with a financial institution, which provides for borrowings up to $3,750,000, as defined. The line had an outstanding balance of $305,000 at February 29, 2004, expires in October 2005 and bears interest at prime plus 1.5% (5.5% at February 29, 2004). The line of credit is secured by substantially all of the assets of the Company. The line of credit agreement requires the Company to maintain certain financial covenants including the maintenance of debt service and tangible net worth ratios. At February 29, 2004, the Company was not in compliance with these ratios and therefore is in technical default under the compliance provisions of its bank line of credit and term loan. In order to fund present and future operations, the Company needs to cure its covenant violations with its lender. While the Company is in the process of attempting to cure its line of credit and term loan violations, there can be 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 significantly reduce, restructure or cease its operations and/or liquidate inventory at amounts below current carrying value to generate the necessary working capital to fund its operations, and if necessary, seek other remedies available to the Company including protection under the bankruptcy laws.

Effective March 1, 2004, the lender increased the rate of interest on the Company s line of credit and term loan to prime plus 3%, which is the default rate specified in the loan agreement. The default rate will remain in effect until all of the designated defaults have been cured.

8) TERM LOAN

In October 2003, the Company obtained a term loan in the amount of $368,000. The term loan had an outstanding balance of $338,000 as of February 29, 2004 and amortizes straight line over 60 months with a balloon payment due in October 2005. It bears interest at prime plus 2.0% (6.0% at February 29, 2004) and is secured by substantially all of the assets of the Company. The loan is payable to the same lender as the Company s line of credit, for which the Company is in technical default under the compliance provisions and therefore has been classified as current in the financial statements as of February 29, 2004.

9) CONVERTIBLE DEBENTURES

The Company had outstanding convertible debentures totaling $405,000 at November 30, 2003. The debentures bore interest at 7.5% per annum, with interest payable quarterly. The debentures matured through March 2004 and during the three-month period ended February 29, 2004, $395,000 of the debentures were repaid. As of February 29, 2004 there was $10,000 in convertible denbentures outstanding, which was subsequently paid in March 2004.

10) RESTRUCTURING CHARGES

In May 2001, the Company announced the closure of its manufacturing facility in Dallas, Texas and its distribution centers in Portland, Oregon and Parker, Colorado. The closure of the two distribution centers was completed during the third quarter and the closure of the Texas facility was completed by the end of the fourth quarter of fiscal 2001. The Company closed these facilities in order to consolidate its U.S. operations into its plant in Rancho Dominguez, California and reduce overhead costs in response to its lower domestic sales. During the three-month period ended February 29, 2004, approximately $10,000 in lease costs were charged against the reserve. The remainder of the restructuring reserve consists of lease abandonment costs of $122,000 (net of probable lease revenue of $54,000).

11) DEFERRED COMPENSATION

The Company had previously made monthly payments aggregating approximately $8,000 to two former employees in conjunction with a liability it had assumed in a business combination in 1992. As of March 2003, the Company ceased making payments to these individuals, as the Company believes it has fulfilled its obligation. The Company is currently in litigation with the parties involved regarding its obligations per the underlying agreement. As of February 29, 2004, the Company had a reserve for retirement benefits to former employees of $1,224,000.

12) DISCONTINUED OPERATIONS

On October 31, 2003, the Company sold its wholly-owned subsidiary in Ireland, Advanced Materials, Ltd. (AML-Ireland). Total consideration for the sale was approximately $3.2 million, consisting of $2.1 million in forgiveness of debt and $1.1 million in cash.

Operating results of AML-Ireland for the three-month period ended February 28, 2003 are shown separately in the accompanying condensed consolidated statement of operations. The condensed consolidated statement of operations for the three-month period ended February 28, 2003 have been restated and operating results of AML-Ireland are shown separately as discontinued operations for those periods.

Results of operations of AML-Ireland for the three-month period ended February 28, 2003 (unaudited) were as follows:

Revenues	$	2,188,000
Costs and expenses:		
Cost of sales		1,705,000
General and administrative		305,000
Other		22,000
Total costs and expenses		2,032,000
Net income from discontinued operations	$	156,000

13) SUBSEQUENT EVENT

On April 22, 2004, the Company s President and CEO and the Company s Chairman of the Board each loaned $150,000 to the Company pursuant to certain promissory notes. The notes are payable on July 21, 2004 and bear interest at 10%. Upon certain events of default, including the nonpayment of principal, the interest rate increases to a default rate of 12%.

In conjunction with the promissory notes, the Company issued warrants to purchase an aggregate of 100,000 shares of the Company s common stock at an exercise price of $0.363 per share. The warrants are exercisable at any time and expire on May 13, 2008. Upon certain events of default, including the nonpayment of principal, the Company shall issue warrants to purchase an additional 100,000 shares of the Company s common stock with the same terms.

ITEM 2 - MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

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

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, 2003 and in Factors That Could Affect Future Results below.

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.

The Company s condensed consolidated financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company incurred net losses from continuing operations of $69,000 and $172,000 in the three-month periods ended February 29, 2004 and February 28, 2003, respectively. At February 29, 2004, the Company had working capital and stockholders deficits and was not in compliance with certain financial covenant ratios pertaining to its line of credit, and therefore is in technical default under the compliance provisions of the line of credit and term loan. The Company is in the process of attempting to cure its line of credit and term loan violations. Management has implemented a plan to reduce expenses and improve sales. The Company has altered its focus in the last few months and will now be concentrating on securing proprietary products primarily for the medical and consumer industry. The objective is to create advanced designs, using current materials. These products will be pursued through aggressive product development and the licensing of existing patented products or technology. These new products are expected to have higher profit margins and be less subject to competition. There can be 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 significantly reduce, restructure or cease its operations and/or liquidate inventory at amounts below current carrying value to generate the necessary working capital to fund its operations, and if necessary, seek other remedies available to the Company including protection under the bankruptcy laws. As a result of these and other factors, the Company s independent certified public accountants, BDO Seidman, LLP, indicated in their report on the 2003 consolidated financial statements, that there is substantial doubt about the Company s ability to continue as a going concern.

Critical Accounting Policies

The Company prepares its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. Accordingly, the Company is required to make estimates, judgments and assumptions that the Company believes are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. The critical accounting policies which the Company believes are the most important to aid in fully understanding and evaluating its reported financial results include the following:

Revenue Recognition

The Company recognizes revenue from product sales when it is realized or realizable and earned, which is generally at the time of shipment and passage of title. Revenue is considered to be realized or realizable and earned when there is persuasive evidence of a sales arrangement in the form of a contract or a purchase order, the product has been shipped, the sales price is fixed or determinable and collectibility is reasonably assured. The Company records revenue for shipping costs charged to customers. The related shipping costs incurred are recorded in cost of sales.

Inventory Valuation

Inventories are stated at the lower of cost (first-in, first-out method) or market. Cost includes raw materials, labor, manufacturing overhead and purchased products. Market is determined by comparison with recent purchases or net realizable value. Net realizable value is based on forecasts for sales of the Company s products in the ensuing years. Should demand for the Company s products prove to be significantly less than anticipated, the ultimate realizable value of the Company s inventories could be substantially less than the amount shown on the accompanying consolidated balance sheets.

Impairment of Long-Lived Assets

The Company assesses the recoverability of its long-lived and certain intangible assets, including goodwill, by determining whether the related asset balance can be recovered through projected undiscounted cash flows. The amount of impairment, if any is measured based on projected discounted future cash flows (fair value) and charged to operations in the period in which impairment is determined by management.

Environmental Remediation

Environmental expenditures that relate to current operations are expensed. Expenditures that relate to an existing condition caused by past operations, and which do not contribute to current or future revenue generation, are expensed. Liabilities are recorded when environmental assessments and/or remedial efforts are probable and the costs can be reasonably estimated. As of February 29, 2004 and November 30, 2003, no liabilities have been recorded.

Restructuring Reserve

Upon approval of a restructuring plan by management with the appropriate level of authority, the Company records restructuring reserves for certain costs associated with plant closures and business reorganization activities. Such costs are recorded as a current liability and primarily include employee severance and contractual obligations. These costs are not associated with nor do they benefit continuing activities. Inherent in the estimation of these costs are assessments related to the most likely expected outcome of the significant actions to accomplish the restructuring. Changing business conditions may affect the assumptions related to the timing and extent of facility closure activities. The Company reviews the status of restructuring activities on a quarterly basis and if appropriate records changes based on updated estimates.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109). Under the asset and liability method of SFAS 109, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates expected to apply when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to amounts, which are more likely than not to be realized. The provision for income taxes is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

Discontinued Operations

In October 2003, the Company sold its wholly owned subsidiary, Advanced Materials Ltd. (AML-Ireland). The condensed consolidated statements of operations for the three-month period ended February 28, 2003 has been restated and operating results of AML-Ireland are shown separately as discontinued operations for that period.

Results of Operations

FY 04 Current Three Months Versus FY 03

Net sales for the quarter ended February 29, 2004 were $2,015,000 versus $5,293,000 for the same period of fiscal 2003, a decrease of $3,278,000 or 61.9%. Revenues from the Singapore strategic manufacturing venture declined to $192,000 in the three-month period ended February 29, 2004 from $2,265,000 in the comparable period in 2003. Revenues from U.S. operations decreased to $1,823,000 in the first quarter of 2004 from $3,028,000 in 2003.

The lower sales for the U.S. operations are due to both lower sales prices and lower sales volumes. The Company has continued to face increased competition and to feel the effects of customers moving their manufacturing operations from the United States to Asia. For the shipping cost sensitive foam commodities that the Company has primarily sold in the past, it has been very difficult to be competitive with the local fabricators in Asia. The Company has recently begun to shift its primary focus to generating its own proprietary opportunities with both its existing customer base as well as new prospects in order to build a more competitive base of business in the United States. Management does not expect significant sales from the new opportunities in the next 6 to 12 months. Sales may continue to decline in the interim period as the Company refocuses its efforts.

The lower sales in Singapore are primarily attributable to an amendment to the Company s manufacturing agreement in Singapore with Foamex Asia (Foamex) to change the vendor of record for the customer supplied under the agreement from the Company to Foamex effective July 17, 2003. Although this change does not affect the Company s share of the profitability under the agreement, it does cause a significant reduction in its reported revenues. Previously, the Company purchased the raw materials for the production of product and billed the end customer and therefore recognized the gross sales and cost of sales on its financials. Under the amended agreement, it no longer purchases the raw materials or bills the end customer and only recognizes its portion of profit as revenue. Management believes this change has been beneficial to the Company as it stills maintains a share of the profits from the Singapore agreement, while it has significantly reduced its capital requirements since it no longer needs to purchase raw materials several months in advance of realizing sales.

One customer, Hewlett Packard, accounted for 70% of consolidated sales for the three-month period ended February 28, 2003. These sales to Hewlett Packard were primarily through the Company s manufacturing agreement with its joint venture partner in Singapore. Sales to Hewlett Packard, Singapore aggregated 51% of consolidated sales for the three-month period ended February 28, 2003. Due to the amendment in the agreement in July 2003, the Company no longer sells directly to Hewlett Packard, but rather receives a percentage of the profit from its joint venture partner. Additionally, sales to Hewlett Packard, Puerto Rico accounted for 19% of consolidated sales for the three-month period ended February 28, 2003. Beginning in late 2003, the Company ceased selling to Hewlett Packard, Puerto Rico due to low gross margins. These changes significantly reduced the Company s percentage of sales accounted for by Hewlett Packard and Hewlett Packard is no longer a significant customer.

Cost of sales for the quarters ended February 29, 2004 and February 28, 2003 were $1,585,000 and $4,793,000, respectively. Cost of sales as a percentage of net sales was 79% for the first quarter of fiscal 2004, compared to 91% for the first quarter of fiscal 2003. The Company s gross profit percentage was 21% in 2004 period, compared to 9% in the 2003 period. The increase in gross profit percentage for the first quarter of 2004 was primarily due to the change in the Singapore agreement noted above. If the amendment had occured prior to the 1st quarter of 2003, the gross profit for the quarter ended February 28, 2003 would have been 15%. The remaining improvement in the gross profit percentage is due to the Company s discontinuing certain low margin sales, and lower labor and overhead costs due to the optimizing of manufacturing processes.

Selling, general and administrative expenses for the first quarter of fiscal 2004 and 2003 were $397,000 and $499,000, respectively, a decrease of $102,000 or 20%. This decrease was due primarily to a reduction in the number of employees as the Company continues to improve individual productivity.

Interest expense for the first quarter of fiscal 2004 and 2003 was $23,000 and $93,000, repectively. Interest expense relates primarily to bank borrowings and is not expected to fluctuate significantly in the near future.

Net income from discontinued operations was $156,000 for the three-month period ended February 28, 2003. On October 31, 2003, the Company sold its wholly-owned subsidiary in Ireland, AML-Ireland.

Net loss for the first quarter of fiscal 2004 was $69,000, compared to a net loss of $16,000 for the first quarter of fiscal 2003. Basic and diluted loss per share for the first quarter of fiscal 2004 was $0.01 per share on a weighted average of 9.2 million shares, compared to a net loss of $0.00 per share on a weighted average of 8.7 million shares for the first quarter of fiscal 2003.

Liquidity and Capital Resources

Cash and cash equivalents were $14,000 at February 29, 2004, compared with $81,000 at November 30, 2003. Operating activities used $33,000 of cash during the first quarter of fiscal 2004, compared with using $1,050,000 in the corresponding period of fiscal 2003. The cash used in operating activities in the first quarter of 2004 resulted primarily from a decrease in accounts receivable, inventory and prepaids and other assets of $85,000 and $41,000 and $55,000, respectively, less an decrease in accounts payable and accrued liabilities of $223,000.

Inventory at February 29, 2004 was $920,000 compared to $939,000 at November 30, 2003.

Net trade receivables at February 29, 2004 were $1,257,000, compared to $1,319,000 at November 30, 2003. The decrease is due to the lower sales volumes during the quarter ended February 29, 2004 compared to the period ended November 30, 2003.

Capital expenditures were $1,000 for the three months ended February 29, 2004, compared to $14,000 for the corresponding period in fiscal 2003. The Company has instituted a Company-wide program to reduce non-essential capital expenditures that 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 three-months ended February 29, 2004 decreased by $540,000.

In October 2003, the Company entered into a new line of credit agreement with a financial institution, which provides for borrowings up to $3,750,000, as defined. The line had an outstanding balance of $305,000 as of February 29, 2004, expires in October 2005 and bears interest at prime plus 1.5% (5.5% at February 29, 2004). The line of credit is secured by substantially all of the assets of the Company. The line of credit agreement requires the Company to maintain certain financial covenants including the maintenance of debt service and tangible net worth ratios. At February 29, 2004, the Company was not in compliance with these ratios and therefore is in technical default under the compliance provisions of its bank line of credit and term loan. In order to fund present and future operations, the Company needs to cure its covenant violations with its lender. While the Company is in the process of attempting to cure its line of credit and term loan violations, there can be 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 significantly reduce, restructure or cease its operations and/or liquidate inventory at amounts below current carrying value to generate the necessary working capital to fund its operations, and if necessary, seek other remedies available to the Company including protection under the bankruptcy laws.

In October 2003, the Company obtained a term loan in the amount of $368,000. The term loan had an outstanding balance of $338,000 as of February 29, 2004 and amortizes straight line over 60 months with a balloon payment due in October 2005. It bears interest at prime plus 2.0% (6.0% at February 29, 2004) and is secured by substantially all of the assets of the Company. The loan is payable to the same lender as the Company s line of credit, for which the Company is in technical default under the compliance provisions and therefore has been classified as current in the financial statements as of February 29, 2004.

Effective March 1, 2004, the lender increased the rate of interest on the Company s line of credit and term loan to prime plus 3%, which is the default rate specified in the loan agreement. The default rate will remain in effect until all of the designated defaults have been cured.

In January 2004, the Company sold approximately 1,220,000 shares of its common stock in a private equity placement for $500,000. Proceeds from the sale were used to pay off existing vendors and for general working capital purposes. The Company may decide to sell additional equity securities or increase its borrowings in order to increase its expenditures for selling and marketing expenses, to fund increased product development, or for other purposes.

Factors That Could Affect Future Results

Banking The Company has incurred losses from operations, has a working capital deficit and has not been in compliance with minimum book net worth and debt service coverage ratio covenants, and therefore is in technical default under the compliance provisions of its bank line of credit and term loan. In order to fund present and future operations, the Company needs to cure its covenant violations with its lender. While the Company is in the process of attempting to cure its line of credit violations, there are no assurance that the Company will be successful in completing this critical task. If the Company is unable to successfully complete this critical task, 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.

Competition The Company encounters aggressive competition in all areas of its business. It has numerous competitors, ranging from several comparable-size companies to many relatively small companies. The majority of the competitors are private, closely held companies. There is also the risk that a supplier to the Company could become a competitor. The Company competes 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 some of its markets, the Company may not be able to successfully compete against current and future competitors, and the competitive pressures faced could harm the Company s 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, it 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, the Company must be able to manufacture sufficient volumes quickly at low enough costs. To do this it 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 to the Company s ability to effectively manage the transition from existing products to new products. If the Company does not manage the transition effectively, 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. The Company s future revenues and earnings could also suffer due to the timing and introduction of new product offerings that compete directly or indirectly with its customers products and new product offerings by its competitors.

Reliance on Suppliers - The Company s manufacturing operations depend on its suppliers ability to deliver quality raw materials and components in time for the Company to meet critical manufacturing and distribution schedules. The Company sometimes experiences 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, it 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 if the Company is not able to increase its sales prices to account for the materials price increases.

Earthquake - The corporate offices and manufacturing division in California are located near major earthquake faults. The ultimate impact on the Company and its general infrastructure is unknown, but operating results could be materially affected in the event of a major earthquake. The Company is 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 the Company s policy to apply strict standards for environmental protection to sites inside and outside the U.S., even when not subject to local government regulations. The Company has not been notified of any environmental infractions.

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

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 the stock price are:

The Company s, its customer s or its competitor s announcement of new or discontinued products,

Quarterly increases or decreases in earnings,

Changes in revenue or earnings estimates by the investment community, and

Speculation in the press or investment community.

General market conditions and domestic or international macroeconomic factors unrelated to the Company s performance may also affect the 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, it cannot reliably predict future revenue and margin trends. Actual trends may cause it to adjust its operations, which could cause period-to-period fluctuations in earnings.

The Company s common stock traded on The Nasdaq SmallCap 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 Nasdaq and traded on the NASD-regulated OTC Bulletin Board (Bulletin Board) under the symbol ADMG.OB. In April 2004, the Company s common stock was delisted from the Bulletin Board, but still trades on the OTC Pink Sheets under the symbol ADMG.PK.

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 and in Item 7A of the Company s 2003 Annual Report on Form 10-K for the fiscal year ended November 30, 2003. There have been no material changes in the Company s market risks during the three months ended February 28, 2004.

ITEM 4 CONTROLS AND PROCEDURES

The Company s Chief Executive Officer (the Company s principal executive officer and principal financial officer), evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a- 15(e), and 15d to 15(e) under the Securities Exchange Act of 1934) as of February 29, 2004 (the Evaluation Date). Based on this evaluation, the Company s disclosure controls and procedures were designed to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms.

Our Chief Executive Officer evaluated the effectiveness of our Internal Controls as of the Evaluation Date and concluded that our current practices and procedures, albeit not as mature or as formal as management intends them to be in the future, are appropriate under the circumstances. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems no evaluation of controls can provide absolute assurance that all control issues within a company have been detected. No significant changes were made to our internal controls or other factors that could significantly affect these controls subsequent to the date of their evaluation.

In connection with BDO Seidman, LLP s audit for the year ended November 30, 2003, our Chief Executive Officer and Audit Committee were made aware of conditions that were considered to be reportable conditions in internal controls under standards established by the American Institute of Certified Public Accountants. BDO Seidman identified material weaknesses in the Company s internal controls as of fiscal year end. The deficiencies noted were (a) the lack of technical competence of the accounting staff, (b) the lack of segregation of duties, (c) the lack of adequate account analysis and reconciliations, which resulted in inaccuracies in the Company s records, (d) insufficient supervision and oversight of the Company s accounting personnel, (e) inability to timely and accurately close the books, (f) operating without a full-time CFO and (g) the improper or lack of accounting for and/or failure to identify transactions. The Company believes such deficiencies were primarily attributable to changes in personnel within the accounting department combined with a lack of management oversight. The Company has been operating without a full-time CFO and was forced to reduce its accounting staff during fiscal 2003 due to financial constraints. Additionally, key accounting personnel resigned during the year leaving the Company with inexperienced staff. Management s primary focus during the later part of fiscal year 2003 has been on the reorganization of the Company, including restructuring its joint venture in Singapore, obtaining new bank financing and selling its subsidiary in Ireland. With these critical tasks behind them, management has renewed their focus on internal controls. Management is currently pursuing the hiring of additional and more experienced accounting staff and a full-time CFO. Additionally, they are establishing procedures for the timely reconciliation of all accounts and manager s review of account reconciliations.

Management has performed additional reconciliation procedures which are designed to ensure that these internal control deficiencies do not lead to future material misstatements in our consolidated financial statements, and to permit the Company s auditors to complete their audits of the Company s consolidated financial statements, notwithstanding the presence of the internal control weaknesses noted above.

Based on the investigation by the Company s audit committee and additional procedures performed by management, the Company has concluded that, except as noted above, and subject to the inherent limitations in all control systems, the Company s current disclosure controls and procedures are sufficient to timely alert them to material information relating to the Company that is required to be included in our periodic Securities and Exchange Committee filings, and that the internal controls are sufficient to provide reasonable assurance that the financial statements are fairly presented in conformity with generally accepted accounting principles.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

The Company had previously made monthly payments aggregating approximately $8,000 to two former employees in conjunction with a liability it had assumed in a business combination in 1992. As of March 2003, the Company ceased making payments to these individuals, as the Company believes it has fulfilled its obligation. The Company is currently in litigation with the parties involved regarding its obligations per the underlying agreement. As of February 29, 2004, the Company had a reserve for retirement benefits to former employees of $1,224,000. On March 25, 2004, the judge ruled to set an arbitration date for the week of June 1 through June 4, 2004, with a completion date of June 8, 2004.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

In January 2004, the Company sold approximately 1,220,000 shares of its common stock in a private equity placement for $500,000. Proceeds from the sale were used to pay off existing vendors and for general working capital purposes.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

In October 2003, the Company entered into a new line of credit agreement with a financial institution, which provides for borrowings up to $3,750,000, as defined. The line expires in October 2005 and bears interest at prime plus 1.5% (5.5% at February 29, 2004). The line of credit is secured by substantially all of the assets of the Company. The line of credit agreement requires the Company to maintain certain financial covenants including the maintenance of debt service and tangible net worth ratios. At February 29, 2004, the Company was not in compliance with these ratios and therefore is in technical default under the compliance provisions of its bank line of credit and term loan. In order to fund present and future operations, the Company needs to cure its covenant violations with its lender. While the Company is in the process of attempting to cure its line of credit and term loan violations, there can be 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 significantly reduce, restructure or cease its operations and/or liquidate inventory at amounts below current carrying value to generate the necessary working capital to fund its operations, and if necessary, seek other remedies available to the Company including protection under the bankruptcy laws.

Effective March 1, 2004, the lender increased the rate of interest on the Company s line of credit and term loan to prime plus 3%, which is the default rate specified in the loan agreement. The default rate will remain in effect until all of the designated defaults have been cured.

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

(a) The 2002 Annual Meeting of Stockholders of the Company was held on December 17, 2003.

(b) Matters voted upon at the meeting and the votes cast with respect to each such matter were as follows:

Proposal	For	Against
Each of the directors listed below was elected and will continue to serve on the Company s board of directors until the 2003 annual meeting of stockholders and until their successors are duly elected and qualified.		
Timothy R. Busch	7,991,177	35,332
N. Price Paschall	7,991,204	35,505
Maurice J. DeWald	7,991,204	35,505
James R. Swartwout	7,991,204	35,505
Robert E. Delk	7,991,204	35,505
To ratify the appointment of BDO Seidman LLP as the Company s independent auditor for the fiscal year ending November 30, 2003.	7,913,570	91,394
To act on a proposal to adopt a new 2003 Stock Plan as described in the accompanying Proxy Statement; and	3,943,796	161,633

ITEM 5. OTHER INFORMATION.

None.

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

(a) Exhibits.

Exhibit No.	Description
31.1	Certifications Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

On April 28, 2004 the Company furnished a report on Form 8-K for April 27, 2004 regarding its earnings release for the quarter and year ended November 30, 2003. The report contained a press releaase under Item 7 Financial Statements and Exhibits and a reference to the press release under Item 12 Disclosure of Results of Operations and Finanical Condition.

SIGNATURES

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

Dated: May 10, 2004	ADVANCED MATERIALS GROUP, INC.	
	By:	/s/ ROBERT E. DELK
		Robert E. Delk
		President, CEO and Chief Financial Officer