NITCHES INC
Form 10-K
November 26, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K
ANNUAL REPORT

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

For the fiscal year ended August 31, 2002

Commission File Number 0-13851

NITCHES, INC.

(Exact name of registrant as specified in its charter)

California	**95-2848021**
(State of Incorporation)	(I.R.S. Employer Identification No.)

10280 Camino Santa Fe, San Diego, California 92121
(Address of principal executive offices)

Registrant s telephone number: (858) 625-2633

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	***Name of each exchange on which registered***
Common Stock, no par value	NASDAQ SmallCap Market

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. |X|

As of October 31, 2002, 1,171,169 shares of the Registrant s common stock were outstanding. On that date, the aggregate market value of such common stock held by non-affiliates of the Registrant based on the last sale of such stock in the NASDAQ SmallCap Market was $7,612,599.

Documents Incorporated By Reference

Portions of the Definitive Proxy Statement, to be filed with the Commission and to be used in connection with the solicitation of proxies to be voted at the Registrant s annual meeting of shareholders to be held in January 2003, are incorporated by reference into Part III of this Report on Form 10-K.

PART I

Item 1 Business

General

Nitches, Inc. (the Company or Nitches) has been in the wholesale clothing business since 1973, and imports finished garments manufactured to its specifications from approximately ten foreign countries. The Company sells all-cotton and cotton blend knit and woven clothing primarily for the female consumer. Retail customers include Cavender s, Kohl s, Mervyns, Sears, Sheplers, and Tractor Supply. The Company sells garments to these and other retailers through its own sales force and through independent sales representatives. Nitches provides fashionable clothing to the popularly priced market segment that generally retails between $10 and $35 per item. The Company competes primarily on the basis of price, quality, the desirability of its fabrics, and the reliability of its delivery and service.

For more than ten years, the apparel market has been marked by deflation and reduced profit margins in certain markets. The consolidation of large retailers has given these retailers leverage to attempt to reduce profit margins to suppliers such as the Company. The Company s response has been to discontinue product lines in areas where it did not believe it could maintain a reasonable profit margin.

The Company currently owns a total of 35 federally registered trademarks. While trademarks owned by the Company have always been important to its marketing and competitive strategy, prior to 1995 they were not central factors influencing its sales. However, subsequent to its reorganization in fiscal year 1995, its trademarks in sleepwear and western wear have become more important in identifying the Company s products. Sleepwear garments are produced in a variety of fabrics and styles, including robes, pajamas, nightshirts and nightgowns, which are sold under the Body Drama® label and retailers private labels. Western wear shirts are sold primarily under the Company labels Adobe Rose® and Southwest Canyon®. Western jeans are sold under the label Posted® through a licensing agreement with a third party supplier.

Product Development and Design

The Company develops merchandise lines for production and importation in two principal ways:

(l) Private Label the Company works with major retailers in developing product lines which the Company then has manufactured and imported and which are generally sold under these retailers private labels

(2) Company Brand the Company develops its own lines of clothing styles which are displayed in Company showrooms and which are also shown to retailers by independent sales representatives. Styles developed by the Company are sold under both Company trademarks and private retailer labels.

For Private Label sales, the Company s sales personnel meet with buyers representing retailers who custom order products by style, fabric, and color. These buyers may provide samples to the Company or may select styles already available in Company showrooms. The Company has an established reputation for its ability to arrange for foreign manufacture on a reliable, expeditious and cost-effective basis.

The Company occasionally creates original garment bodies (styles). More importantly, the Company produces garments with original fabric prints and designs. The Company also responds to frequent style changes in the women s clothing business by maintaining a program of evaluating current trends in style and fabric. In an effort to continually stay abreast of fashion trends, representatives of the Company shop at exclusive department and specialty stores in the United States, Europe, Japan and other countries that are known to sell merchandise with advanced styling direction. The Company also seeks input from selected customers. The Company then selects styles, fabrics, and colors that it believes reflect current fashion trends.

Sources of Supply

Almost 95% of the garments sold by the Company are manufactured abroad. Contracting with foreign manufacturers enables the Company to take advantage of prevailing lower labor rates, with the consequent ability to produce a quality garment that can be retailed in the popular, value and moderate price ranges. The Company arranges for the production of garments with suppliers on a purchase order basis, with each order generally backed by an irrevocable letter of credit. The Company does not have any long-term contractual arrangements with manufacturers. This provides the Company with flexibility regarding the selection of manufacturers for future production of goods. The Company believes that it could replace the loss of any particular manufacturer in any country within a reasonable time period. However, in the event of the loss of a major manufacturer the Company could experience a temporary interruption in supply.

As a result of import restrictions on certain garments imposed by bilateral trade agreements between the United States and certain foreign countries, the Company has sought diversity in the number of countries in which it has manufacturing arrangements. The percentage of total purchases from particular countries varies from period to period based upon quota availability and price considerations. The Company has arranged, and will continue to arrange, for production in the United States when economically feasible to meet special needs.

The following table shows the percentage of the Company s total purchases, not including freight charges, duties and commissions, from each country for the years ended August 31, 2002, 2001, and 2000.

	Percent of Total Purchases by Country		
Year ended August 31,	**2002**	**2001**	**2000**
United Arab Emirates	60.86	68.25	58.94
Macau	11.25	12.47	16.51
Cambodia	6.81		
India	6.45	7.34	7.66
Sri Lanka	5.63	7.17	5.66
United States	5.03	1.19	2.14
Hong Kong	2.32	.95	4.14
Countries less than .95% each in the current year	1.64	2.63	4.95

The Company owns 100% of the outstanding capital stock of Nitches Far East Ltd., a Hong Kong corporation that performs production coordination, quality control and sample production services for the Company. Furthermore, the Company has production control liaison offices in Cambodia, India, Sri Lanka, and the United Arab Emirates. The Company and its subsidiaries perform no material manufacturing and maintain no significant assets outside the United States.

In some cases, the manufacturer or agent with whom the Company contracts for production may subcontract work. Most of the listed countries have numerous suppliers that have the technical capability to manufacture garments of the type sold by the Company. The availability of alternate sources tends to offset the risk associated with the loss of a major manufacturer.

The Company believes that the production capacity of foreign manufacturers with which it has developed, or is developing, a relationship is adequate to meet the Company s production requirements for the foreseeable future. However, because of existing and potential import restrictions, the Company continues to attempt to diversify its sources of supply.

When management believes, based on previous experience and market performance, that additional orders for certain garments will be received, the Company may place production runs in amounts in excess of firm customer orders. This may allow the Company to achieve overall lower costs as well as to be able to respond more quickly to customer delivery requirements. However, the Company bears the consequent risk if garments purchased in advance of receipt of customer purchase orders do not sell.

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Quality Control

Company representatives regularly visit manufacturers to inspect garments and monitor production facilities in order to assure timely delivery, maintain quality control and issue inspection certificates. Furthermore, through these representatives and independent inspectors from major retailers, the Company ensures that the factories the Company uses for production adhere to policies consistent with prevailing labor laws. A sample of garments from a percentage of each production run is inspected before each shipment. Letters of credit arranged by the Company require, as a condition to the release of funds to the supplier, that a representative of the Company sign an inspection certificate.

Marketing and Distribution

The Company sells its products through an established sales network consisting of both in-house sales personnel and independent sales representatives. The Company does not generally advertise, although customers sometimes feature the Company s products in their advertisements. For both Company Brand and Private Label sales, employees operating in Company showrooms in New York City and Los Angeles represent the Company in soliciting orders nationally from approximately 8 major customers. In addition, senior executives of the Company have primary responsibility for sales to certain key accounts. The Company s products are marketed by 19 independent commissioned sales representatives, each of which have been assigned a primary area of responsibility.

At present, most garments are shipped by suppliers in bulk form to the Company s warehouse in San Diego, where they are sorted, stored and packed for distribution to customers. From time to time, the Company may rent additional short-term warehouse space as needed to accommodate its requirements during peak shipping periods. In addition, to facilitate shipping to customers, some of its overseas suppliers perform sorting, price ticketing, hanging, and packing functions.

Purchase orders may be canceled by the Company s customers in the event of late delivery or in the event of receipt of nonconforming goods. Late deliveries usually are attributable to production or shipping delays beyond the Company s control. In the event of canceled purchase orders, rejections or returns, the Company will sell garments to other retailers, off-price discount stores or garment jobbers. The Company has, in the past, often been able to recover from its manufacturers some portion of its expenses or losses associated with sales below cost for causes attributable to manufacturing problems. However, the Company has also historically experienced losses on merchandise that is rejected or returned. Past losses on rejected and returned merchandise have not been material to the Company.

The Company s business is concentrated on certain significant customers. Sales to Mervyn s, Kohl s and Sears accounted for 40.5%, 21.5% and 10.9%, respectively, of the Company s net sales in fiscal 2002. Mervyn s, Kohl s and Sears accounted for 39.9%, 18.6% and 10.9%, respectively, of the Company s net sales in fiscal 2001. While the Company believes its relationships with its major customers are good, because of competitive changes and availability of the types of garments sold by the Company from a number of other suppliers, there is the possibility that any customer could lower, or raise, the amount of business it does with the Company. If the Company experiences a significant decrease in sales to any of its major customers, and is unable to replace such sales volume with sales to other major customers, there could be a material adverse financial effect on the Company.

Import Restrictions

The ability of the Company to import garments is regulated by import restrictions that limit the specific number of garments that may be imported from any country during a specific period. Government import quotas of various types are imposed on substantially all of the products imported by the Company from substantially all of the countries from which the Company purchases garments. Because of these quota restrictions, the Company has sought diversity in the number of countries in which it has garments manufactured.

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The Agreement on Textile and Clothing (the ATC), which became effective on January 1, 1995, provided the basic guidelines for administering import quotas and related matters. The ATC contains three provisions that will affect the Company s business to varying degrees in the future. First, the ATC requires that import quotas be phased out in four stages over a ten-year period. However, quotas on substantially all of the garments imported by the Company are not scheduled to be phased out until the year 2005. Second, over the first six years, import tariffs will be reduced from an average of 19% to 17.5%. While the tariff reductions apply to most apparel items, the sizes of the reductions are extremely small and are not likely to have a material impact on the Company s overall cost of merchandise. Finally, new rules of origin took effect on July 1, 1996 whereby the country in which the garment is assembled is deemed the country of origin instead of the country in which the fabric is cut. The biggest impact of the rule change has been on garments produced in China, which assembles large quantities of apparel cut in nearby countries such as Macau, Singapore and Taiwan. Approximately 13.6% of the Company s garments were produced in Macau, Hong Kong and China in fiscal 2002. The Company does not expect a significant disruption in its garment purchases as a result of the country of origin rule change.

The Company closely monitors the status of applicable import quotas and the extent to which they are being filled. The Company bases its production decisions, in part, on whether a particular supplier country has entered into an agreement with the United States restricting trade in certain garments and, if so, the extent to which the applicable quota imposed for a particular year is expected to be filled by a scheduled shipment date. In some cases, the Company has responded to the anticipated exhaustion of a particular quota by having goods manufactured and shipped prior to the receipt of purchase orders or well in advance of scheduled delivery dates in order to be assured that garments will be imported into the United States before the applicable quota is filled. In these instances, the Company is required to hold garments in inventory, sometimes for several months, before shipment to customers. This can occur, normally, toward the end of a calendar year.

Import restrictions have, in some cases, increased the cost of finished goods to the Company as a result of increased competition for a restricted supply of goods. The Company s future results may also be affected by additional bilateral or unilateral trade restrictions, a significant change in existing quotas, political instability resulting in the disruption of trade from exporting countries, or the imposition of additional duties, taxes and other charges on imports.

Because of import restrictions and quotas, embargos, and political instability in some countries of origin, the Company may be unable, from time to time, to import certain types of garments. Because of the Company s dependence on foreign suppliers, a significant tightening or utilization of import quotas for the types of garments imported by the Company, applicable to a substantial number of countries from which the Company imports, could force the Company to seek other sources of supply and to take other actions which could increase costs of production. This could also cause delays in production and result in cancellation of orders. Any of these factors could result in an adverse financial impact on the Company.

The Company believes it has the ability to locate, establish relationships with and develop manufacturing sources in countries where the Company has not previously operated. Whenever possible, the Company moves production to countries in which applicable quotas remain unfilled or to countries in which no quotas are imposed. The Company may also shift production to non-quota garments if a market for such garments exists. The time required to commence contract production in supplier countries ranges from several weeks in the case of a country with a relatively well developed garment manufacturing industry to four months or more for a country in which there are less developed capabilities. The cost to the Company of arranging for production in a country generally involves management time and associated travel expenses.

Backlog

At August 31, 2002 and August 31, 2001 the Company had unfilled customer orders of $14.8 million and $14.6 million, respectively, with such orders generally scheduled for delivery by January 2003 and 2002, respectively. The increase in backlog was in the Company s sleepwear product line. These amounts include both confirmed orders and unconfirmed orders that the Company believes, based on industry practice and past experience, will be confirmed. While cancellations, rejections and returns have generally not been material in the past, there can be no assurance that such action by customers will not reduce the amount of sales realized from the backlog of orders at August 31, 2002.

On September 28, 2002, port operators subjected ports of entry along the West Coast to a lockout of union workers over the issue of worker productivity as the result of stalled contract negotiations. On October 11th, the Bush Administration suspended the lockout for an 80-day cooling off period under the auspices of the Taft-Hartley Act. The 12-day lockout created a significant backlog of container ships awaiting berths in West Coast ports. In Los Angeles, the primary port of entry for the Company s products, the backlog approached 200 ships.

Consequently, the Company has experienced delays of anticipated deliveries of inventory to its warehouse during October ranging from several days to weeks. As a result of these delays, there can be no assurances that the Company will be able to meet the delivery terms of orders placed by its customers and included in the backlog as of August 31, 2002. Because of its reliance upon a few significant customers, the cancellation of any orders by these customers could have a material adverse effect on the Company.

Until the port operators and unions reach a labor agreement, the Company will closely monitor the routing of goods through Los Angeles and may divert some shipments to other ports in order to minimize the impact of any work slowdown, strike, lockout or other action that may arise from the labor dispute at West Coast ports. Additional handling and rerouting of shipments may increase costs for the Company.

Raw Materials

A substantial majority of the clothing sold by the Company is made of l00% cotton, although the Company also utilizes cotton blends, polyester and rayon fabrics. All of these fabrics are readily available in most countries in which the Company contracts for production and are easily imported to those countries that do not have an internal supply of such fabric. The Company is not dependent on a single source of supply for fabric that is not readily replaceable.

Competition

The women s clothing business is highly competitive and consists of many manufacturers and distributors, none of which accounts for a significant percentage of total sales, but many of which are larger and have substantially greater resources than the Company. The Company competes with a number of companies which import clothing from abroad for wholesale distribution, with domestic retailers having established foreign manufacturing capabilities and with domestically produced goods. Management believes that the Company competes upon the basis of price, quality, the desirability of its fabrics and styles, and the reliability of its service and delivery. In addition, the Company has developed long-term working relationships with manufacturers and agents, which presently provide the Company with reliable sources of supply. The Company s ability to compete effectively is dependent, in part, on its ability to retain managerial personnel with experience in locating, developing and maintaining reliable sources of supply and to retain experienced sales and product development personnel.

Employees

As of August 31, 2002, the Company had 32 full-time employees, of whom nine worked in executive, administrative or clerical capacities and 23 worked in sales, design, and production. The Company may also employ temporary personnel on a seasonal basis. None of the Company s employees is represented by a union. The Company considers its working relationships with its employees to be good and has never experienced an interruption of its operations due to any kind of labor dispute. The Company contracts with an unrelated entity to provide warehouse services.

Cautionary Statement Under the Private Securities Litigation Reform Act of 1995

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

Exchange Commission.

Item 2 Properties

The Company leases one showroom in New York and one in Los Angeles with an aggregate monthly gross rental of approximately $11,000. The Company leases a 30,000 square foot warehouse with administrative offices in San Diego with a monthly lease payment of approximately $18,000. The Company may lease additional short-term warehouse space from time to time as needed.

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Item 3 Legal Proceedings

There were no material legal proceedings to which the Company or any of its subsidiaries was a party in the fiscal year ended August 31, 2002.

Item 4 Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders during the fourth quarter of fiscal 2002.

PART II

Item 5 Market for the Registrant s Common Stock and Related Shareholder Matters

The Company s Common Stock trades on The NASDAQ SmallCap Market under the symbol NICH. The number of record holders of the Common Stock was 118 on October 31, 2002. The Company believes that there are a significant number of beneficial owners of its Common Stock whose shares are held in street name . The closing sales price of the Common Stock on October 31, 2002 was $6.50 per share.

The high and low closing sale prices, adjusted for stock dividends, for each fiscal quarter ending on the specified date during the last two fiscal years were as follows:

	High	Low
November 30, 2000	6.56	4.69
February 28, 2001	9.47	4.53
May 31, 2001	8.25	4.53
August 31, 2001	8.50	5.75
November 30, 2001	5.79	4.49
February 28, 2002	5.44	4.36
May 31, 2002	6.31	5.19
August 31, 2002	6.74	5.45

The Company does not have a quarterly dividend policy. However, during fiscal years 2001 and 2002, the Company declared and paid the following special dividends:

Date Paid	Dividend per share
November 30, 2000	$.25
February 23, 2001	.50
May 18, 2001	.25
August 17, 2001	.35
November 23, 2001	.15
January 25, 2002	.15
April 26, 2002	.10
July 26, 2002	.05

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Item 6 Selected Financial Data (In thousands, except per share amounts)

	2002	2001	2000	1999	1998
Operating Results:					
Net sales	$ 29,480	$ 33,679	$ 39,471	$ 31,473	$ 31,041
Cost of goods sold	22,086	24,733	29,156	23,275	23,776
	7,394	8,946	10,315	8,198	7,265
Selling, general and administrative expenses	7,151	7,333	7,403	7,267	8,437
Income (loss) from operations	243	1,613	2,912	931	(1,172)
Other income	16	247	20	164	178
Interest income (expense), net	(80)	(162)	(100)	(44)	190
Income (loss) before taxes	179	1,698	2,832	1,051	(804)
Provision (benefit) for income taxes	63	615	946	410	(807)
Net income	$ 116	$ 1,083	$ 1,886	$ 641	$ 3
Earnings per share:					
Basic	$ 0.10	$ 1.02	$ 1.77	$ 0.52	$
Diluted	$ 0.10	$ 1.02	$ 1.77	$ 0.52	$
Cash dividends per common share	$ 0.45	$ 1.35	$ 1.65	$	$

	2002	2001	2000	1999	1998
Financial Position:					
Cash and cash equivalents	$ 182	$ 192	$ 314	$ 201	$ 1,338
Receivables	4,523	3,179	4,262	3,302	5,435
Income taxes receivable	118	75			5
Inventories	5,306	5,408	5,055	4,553	5,340
Total current assets	10,378	9,157	9,857	8,993	12,595
Total assets	10,503	9,289	10,011	9,786	13,782
Accounts payable and accrued expenses	4,277	2,684	2,951	2,954	3,211
Total current liabilities	4,277	2,684	3,049	2,954	3,211
Shareholders equity	6,226	6,605	6,962	6,832	10,571
Other Financial Information:					
Profitability:					
Gross margin	25.08%	26.60%	26.10%	26.00%	23.40%
Operating margin (deficit)	0.82%	4.80%	7.40%	3.00%	(3.80%)
Net income as percent of net sales	0.39%	3.20%	4.80%	2.00%	
Liquidity:					
Current ratio	2.43	3.41	3.23	3.04	3.92
Working capital	$ 6,101	$6,473	$ 6,808	$6,039	$ 9,384
Share data:					
Weighted average number of common shares (000 s):					
Basic	1,112	1,065	1,065	1,226	2,218
Diluted	1,112	1,065	1,065	1,226	2,203
Number of common shares outstanding at year end	1,171	1,065	1,065	1,065	2,012

Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations

Years Ended August 31, 2002 and 2001

Net sales for the fiscal year ended August 31, 2002 decreased approximately $4.2 million or 12.5 % compared to the fiscal year ended August 31, 2001 due to a decrease in unit sales in both the Company s sleepwear and western wear product lines, as a result of the general slowdown in the economy continued from fiscal 2001. Furthermore, cost of sales as a percent of net sales increased by 1.5%, leading to a decline in gross profit margin from 26.6% to 25.1% between fiscal 2001 and 2002. This decrease came as a result of lower realized gross margins across all product lines.

The Company s product mix constantly changes to reflect customer mix, fashion trends and changing seasons. Consequently, gross margins are likely to vary on a quarter-to-quarter basis and in comparison to gross margins generated in prior fiscal years.

Selling, general and administrative expenses decreased slightly in dollar amount from $7.3 million in fiscal 2001 to $7.2 million in fiscal 2002, primarily due to reductions in salaries and commissions as a result of lower sales volume. However, selling, general and administrative expenses increased as a percent of net sales from 21.8 % in fiscal 2001 to 24.3% in fiscal 2002, due primarily to the disproportionate decrease in sales when compared to the decrease in selling, general and administrative expenses.

Years Ended August 31, 2001 and 2000

Net sales for the fiscal year ended August 31, 2001 decreased approximately $5.8 million or 14.7 % compared to the fiscal year ended August 31, 2000 due to a decrease in unit sales in both the Company s sleepwear and western wear product lines, as a result of the general slowdown in the economy. However, cost of sales as a percent of net sales decreased by 0.5%, leading to an improvement in gross profit margin from 26.1% to 26.6% between fiscal 2000 and 2001. This increase came as a result of higher realized gross margins across all product lines.

Selling, general and administrative expenses decreased slightly in dollar amount from $7.4 million in fiscal 2000 to $7.3 million in fiscal 2001, primarily due to reductions in salaries and commissions as a result of lower sales volume. However, selling, general and administrative expenses increased as a percent of net sales from 18.8 % in fiscal 2000 to 21.8% in fiscal 2001, due primarily to the disproportionate decrease in sales when compared the decrease in selling, general and administrative expenses. Additionally, in the second quarter of fiscal 2001 the Company incurred one-time expenses of approximately $150,000 related primarily to the direct cost of closing an overseas buying office in favor of an agency relationship.

In the third quarter of fiscal 2001, the Company recorded $150,000 of other income as a result of settling a note receivable, which it held related to the sale of product lines in 1995. The Company had fully reserved the total note of $600,000 and accounted for it on a cost recovery basis, recording income only upon receipt of payments. The settlement was reached with the buyer in a credit workout reorganization. In addition to making interest payments of 4% per year, from July 1995 through July 2000 the buyer paid the Company approximately $1.5 million in rent, taxes, utilities and maintenance under a sublease agreement. Since July 2000, the Company has not sublet property to the buyer.

Liquidity and Capital Resources