Advanced Materials Group, Inc.
Form 10QSB
October 15, 2008

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

(Mark One)

x QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED AUGUST 31, 2008

o TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE EXCHANGE ACT FOR THE TRANSITION PERIOD FROM_________________ TO__________________

COMMISSION FILE NO. 0-16401

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

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

3303 LEE PARKWAY, SUITE 105, DALLAS, TEXAS 75219
(Address of principal executive offices) (Zip code)

(972) 432-0602
(Issuer's telephone number)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or 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 o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes o No x

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: Common Stock, $.001 par value, 12,346,026 shares outstanding as of October 3, 2008.

Transitional Small Business Disclosure Format (check one): Yes o No x

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

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

	Three Months Ended		Nine Months Ended	
	August 31, 2008	August 31, 2007	August 31, 2008	August 31, 2007
Net sales	$ 3,216,863	$ 2,838,600	$ 9,045,522	$ 7,989,659
Cost of sales	2,455,175	2,202,729	6,883,755	6,251,782
Gross profit	761,688	635,871	2,161,767	1,737,877
Operating expenses:				
Selling, general and administrative	607,552	514,324	1,808,237	1,294,320
Depreciation and amortization	9,800	8,385	32,104	33,205
Total operating expenses	617,352	522,709	1,840,341	1,327,525
Income from operations	144,336	113,162	321,426	410,352
Other income (expense):				
Interest expense	(22,765)	(24,879)	(76,545)	(66,290)
Other, net	(1,576)	(1,961)	(9,555)	17,432
Total other expense, net	(24,341)	(26,840)	(86,100)	(48,858)
Income tax benefit	578	15,514	11,277	173,388
Net income	$ 120,573	$ 101,836	$ 246,603	$ 534,882
Basic and diluted net income per share	$ 0.01	$ 0.01	$ 0.02	$ 0.04
Weighted average common shares outstanding:				
Basic	12,346,026	12,146,026	12,269,214	12,141,915
Diluted	12,429,804	12,407,980	12,403,235	12,362,823

See accompanying notes to consolidated financial statements

ADVANCED MATERIALS GROUP, INC.
CONSOLIDATED BALANCE SHEETS

	August 31, 2008 (unaudited)	November 30, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 325,165	$ 462,701
Accounts receivable, net	2,890,646	1,799,657
Inventories, net	1,680,095	1,086,968
Current portion of deferred tax asset	79,340	858,064
Prepaid expenses and other	205,852	398,133
Total current assets	5,181,098	4,605,523
Property and equipment, net	674,211	736,398
Deferred tax assets	790,000	-
Other assets	69,395	69,395
Total assets	$ 6,714,704	$ 5,411,316
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 245,747	$ 251,301
Accrued liabilities	139,904	119,468
Line of credit	2,200,000	1,354,167
Current portion of term note	29,400	-
Current portion of capital lease obligations	70,199	59,782
Total current liabilities	2,685,250	1,784,718
Term note, net of current portion	112,700	-
Capital lease obligations, net of current portion	60,226	122,442
Total liabilities	2,858,176	1,907,160
Commitments and contingencies		
Stockholders' equity:		
Preferred stock-$.001 par value; 5,000,000 shares authorized; no shares issued and outstanding	--	--
Common stock-$.001 par value; 25,000,000 shares authorized; 12,346,026 and 12,146,026 shares issued and outstanding at August 31, 2008 and November 30, 2007, respectively	12,346	12,146
Additional paid-in capital	8,600,540	8,494,971
Accumulated deficit	(4,756,358)	(5,002,961)
Total stockholders' equity	3,856,528	3,504,156
Total liabilities and stockholders' equity	$ 6,714,704	$ 5,411,316

See accompanying notes to consolidated financial statements

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

	Nine Months Ended	
	August 31, 2008	August 31, 2007
Cash flows from operating activities:		
Net income	$ 246,603	$ 534,882
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	87,870	124,914
Deferred tax assets	(11,276)	(217,178)
Stock based compensation	33,169	132,705
Changes in operating assets and liabilities:		
Accounts receivable	(1,090,989)	(79,477)
Inventories	(593,127)	(343,585)
Prepaid expenses and other	192,281	(317,085)
Accounts payable and accrued liabilities	14,882	(103,024)
Net cash used in operating activities	(1,120,587)	(267,848)
Cash flows from investing activities:		
Purchases of property and equipment	(25,683)	(284,843)
Net cash used in investing activities	(25,683)	(284,843)
Cash flows from financing activities		
Net borrowings under line of credit	845,833	369,150
Proceeds from term note	147,000	-
Repayments of long-term obligations	(56,699)	(56,380)
Exercise of stock options and warrants	72,600	5,099
Net cash provided by financing activities	1,008,734	317,869
Net change in cash and cash equivalents	(137,536)	(234,822)
Cash and cash equivalents, beginning of period	462,701	441,860
Cash and cash equivalents, end of period	$ 325,165	$ 207,038
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$ 22,765	$ 66,920
Income taxes	$ -	$ 28,450
Non-cash transaction		
Equipment acquired via capital lease	$ -	$ 109,000

See accompanying notes to consolidated financial statements

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ADVANCED MATERIALS GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1) BASIS OF PRESENTATION

The accompanying unaudited 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 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 August 31, 2008 and the results of operations and cash flows for the interim periods ended August 31, 2008 and 2007. However, these results are not necessarily indicative of results for any other interim period or for the year. The accompanying consolidated financial statements should 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-KSB for the fiscal year ended November 30, 2007.

Principles of Consolidation

The consolidated financial statements include the accounts of Advanced Materials Group, Inc. ("AM" or the "Company") and its wholly owned subsidiary, Advanced Materials, Inc. ("AM"). All significant intercompany accounts and transactions have been eliminated.

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.

2) EARNINGS 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 share equivalents including stock options have been excluded for the three and nine-month periods ended August 31, 2008 and 2007, as their effect would be antidilutive.

There were 243,200 and 35,000 potentially dilutive options outstanding at August 31, 2008 and 2007, respectively, that were not included in the computation of net income per share because the impact would be anti-dilutive.

3) STOCK BASED COMPENSATION

On November 1, 2006, the Company adopted Statement of Financial Accounting Standard No. 123(R), Share-Based Payment (“SFAS 123(R)”), and has elected to use the modified prospective method, which requires the application of the accounting standard to all share-based awards issued on or after November 1, 2006 and any outstanding share-based awards that were issued but not vested as of November 1, 2006.

For the three-month periods ended August 31, 2008 and 2007, the adoption of FAS 123(R) resulted in incremental stock-based compensation expense of $1,700 and $129,305, respectively. For the nine-month periods ended August 31, 2008 and 2007, the adoption of FAS 123(R) resulted in incremental stock-based compensation expense of $33,169 and $132,705, respectively. This amount includes compensation expense related to stock options granted prior to November 1, 2006, but not yet vested as of November 1, 2006, based on the grant date fair value estimated in accordance with the pro-forma provisions of SFAS 123. Stock compensation expense has been recorded as selling, general and administrative expense in the accompanying consolidated statements of income.

The following is a summary of all stock option transactions for the nine months ended August 31, 2008:

	Shares		Weighted Average Price	Weighted Average Remaining Contractual Term (Years)		Aggregate Intrinsic Value
Outstanding at November, 2007	428,200	$	0.71			
Granted	60,000		0.63			
Cancelled or expired	(35,000)	$	2.30			
Outstanding at August 31, 2008	453,200	$	0.57	7.10	$	33,500
Options exercisable at August 31, 2008	423,200	$	0.59	7.26	$	28,600

As of August 31, 2008 there was $5,667 of total unrecognized stock based compensation related to nonvested share-based compensation awards granted under the stock option plans. This cost is expected to be recognized over a weighted average period of approximately 1 year.

The Company used the Black-Scholes Option Pricing Model ("BSOPM") to determine the fair value of option grants. No option grants were made during the third quarter of fiscal 2008. During the third quarter of fiscal 2007, the Company granted 183,200 fully vested options to directors at an exercise price of $0.90. The options were valued using the BSOPM and the following assumptions: stock price on date of grant - $0.90, exercise price - $0.90, expected life – 5 years, volatility – 101% and a risk free rate of 5.07%. The calculated fair value of each option was approximately $0.70.

4) INVENTORIES

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

		August 31, 2008 (unaudited)		November 30, 2007
Raw Materials	$	665,670	$	562,236
Work-in-process		157,085		148,104
Finished Goods		884,340		376,628
Less allowance for obsolete inventories		27,000		--
	$	1,680,095	$	1,086,968

5) SINGAPORE ROYALTY AGREEMENT

Consolidated net sales and gross profit include income from the Singapore royalty agreement of $0 and $284,497 for the three-month periods ended August 31, 2008 and 2007, respectively, and $0 and $476,985 for the nine-month periods ended August 31, 2008 and 2007, respectively. Based on the structure of the agreement, the Company has no cost of sales related to this income. Net income attributable to this agreement was $0 and $256,057 for the three-month periods ended August 31, 2008 and 2007, respectively and $0 and $429,286 for the nine-month periods ended August 31, 2008 and 2007, respectively.

On or about October 18, 2007, the Company filed suit in the Superior Court of the State of California, County of Orange, Central Justice Center, against Foamtec (Singapore) Pte. Ltd., a private limited company incorporated in

Singapore, and Foamex Asia Ltd., a private company incorporated in Burma, formerly the Kingdom of Thailand (collectively, "Foamtec"). In December of 1998, the Company and Foamtec entered into a Manufacturing Agreement, whereby the Company and Foamtec agreed to work cooperatively to manufacture and sell certain foam components to Hewlett Packard Company and certain other buyers. As part of the Manufacturing Agreement, Foamtec agreed to act as fiduciary agent for the Company in distributing the manufactured product to Hewlett Packard, its successors and assigns. The term of the Manufacturing Agreement was for ten years, which could be extended by either party for an additional five years. Foamtec had the option to purchase the Company's interest in the Manufacturing Agreement by paying a price to be calculated on the profits expected under the entire remaining term which, by definition, included its entire term, including the additional five years if the Company exercised its extension right. In 2006, the Company gave notice to Foamtec of its election to extend the term of the Manufacturing Agreement for an additional five years in accordance with its rights under the Manufacturing Agreement. Thereafter, Foamtec gave notice of its election to purchase the Company's interest in the Manufacturing Agreement, and tendered certain funds in claimed discharge of its payment obligations thereunder. Foamtec asserted that this payout right only applied to the initial term, and not the extended term, and therefore remitted funds that represented the expected profits through the end of the initial term. The Company therefore sued Foamtec for breach of contract for Foamtec's failure to pay the Company the amount of expected profits for the extended term, as well as for breach of fiduciary duty. The Company is seeking compensatory damages in excess of $1,000,000, exemplary damages in an amount subject to proof, interest as provided by law and costs associated with the suit.

6) ACCOUNTING CHANGES

In June, 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109, Accounting for Income Taxes (FIN48), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest, and penalties, accounting in interim periods, disclosure and transition. The Company adopted FIN 48 as of December 1, 2007 and the adoption did not have a material impact to the Company’s consolidated financial statements or effective tax rate and did not result in any unrecognized tax benefits.

Interest costs and penalties related to income taxes are classified as interest expense and general and administrative costs, respectively, in the Company’s consolidated financial statements. For the three and nine-months ended August 31, 2008 and 2007, the Company did not recognize any interest or penalty expense related to income taxes. It is determined not to be reasonably possible for the amounts of unrecognized tax benefits to significantly increase or decrease within the next 12 months. The Company is currently subject to a three year statute of limitations by major tax jurisdictions. The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction.

7) LONG-TERM DEBT

On June 18, 2008, the Company entered into a term note with JPMorgan Chase Bank, N.A. for the sum of $147,000 with a maturity date of June 18, 2013. Payments are due in consecutive monthly installments of $2,450 plus interest at the prime rate. This note is collateralized by certain equipment owned by the Company.

On July 14, 2008, the Company amended their line of credit to extend the facility to $2,500,000.

ITEM 2 -MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

The following discussion should be read in conjunction with the unaudited 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, but are not limited to, 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-KSB for the year ended November 30, 2007 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. Advanced Materials Group, Inc. undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

RESULTS OF OPERATIONS THREE MONTHS ENDED AUGUST 31, 2008 COMPARED TO THE THREE MONTHS ENDED AUGUST 31, 2007

Net sales for the quarter ended August 31, 2008 were $3,216,863 versus $2,838,600 for the same period of fiscal 2007, an increase of $378,263 or 13%. Revenues from the Singapore royalty agreement decreased to $0 in the three-month period ended August 31, 2008 from $284,497 in the comparable period in 2007. Revenues from U.S. operations increased to $3,216,863 in the third quarter of 2008 from $2,554,103 in 2007. Revenues from U.S. Operations increased 26% in the third quarter over the previous year's third quarter.

The increase in sales for U.S. operations is due to increased sales volumes from its top 5 customers and the signing of a license agreement with Easy Industries dated and effective January 1, 2008, which contributed to the increase in sales overall. The license agreement resulted in $529,000 in sales for the third fiscal quarter of 2008. The Company continues its strategic focus on 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.

The Singapore royalty agreement generated gross profit of $0 and $284,497 for the three month periods ended August 31, 2008 and 2007, respectively. Net income attributable to this agreement was $0 and $256,057 for the three-month periods ended August 31, 2008 and 2007, respectively. The Company is currently involved in litigation with Foamtec arising out of a dispute associated with the final payment to the Company under the royalty agreement. See Part II - Other Information, Item 1: Legal Proceedings, for further information.

Cost of goods sold for the quarters ended August 31, 2008 and 2007 were $2,455,175 and $2,202,729, respectively. The Company's gross profit margin was 24% in the third quarter of 2008 and 22% in the third quarter of 2007. The increase in costs of goods sold results from the increase in raw material costs and incoming freight costs. The Company's top five customers products are foam based products, which are petroleum-based products, and we continue to see increases in raw material and freight costs due to increases in costs of petroleum.

Selling, general and administrative expenses for the third quarter of fiscal 2008 and 2007 were $607,552 and $514,324, respectively, representing an increase of $93,228 or 18%. These costs increased over the previous year due to additional staff added in sales, quality control and the addition of staff to fulfill the Miss Oops® product line. The Company obtained ISO 13485 certification in 2007 and is currently pursuing the ISO AS9100 certification in order to allow the Company to bid for business within the Aerospace Industry. The Company also has added customer service staff to further its commitment to service our customers with the upstart of the fulfillment services business that began in the third quarter of 2008.

Interest expense for the third quarter of fiscal 2008 and 2007 was $22,765 and $24,879, respectively. Interest expense relates primarily to bank borrowings and will increase or decrease based on interest rate fluctuations.

The Company recorded an income tax benefit of $578 in the third quarter of 2008. This benefit was mainly a result of the Company recording a deferred tax asset related to stock based compensation.

Net income for the third quarter of fiscal 2008 was $120,573 compared to $101,836 for the third quarter of fiscal 2007. Basic and diluted net income per share for the third quarter of fiscal 2008 was $0.01 per share, compared to $0.01 per share for the third quarter of fiscal 2007.

RESULTS OF OPERATIONS NINE MONTHS ENDED AUGUST 31, 2008 COMPARED TO THE NINE MONTHS ENDED AUGUST 31, 2007

Net sales for the nine months ended August 31, 2008 were $9,045,522 versus $7,989,659 for the same period of fiscal 2007, an increase of $1,055,863 or 13%. Revenues from the Singapore royalty agreement decreased to $0 in the nine-month period ended August 31, 2008 from $476,985 in the comparable period in 2007. Revenues from U.S. operations increased to $9,045,522 in the first nine months of 2008 from $7,512,673 in 2007. Revenues from U.S. operations increased 20% in the nine months ended August 31 over the same period in prior year.

The increase in sales for U.S. operations is due to increased sales volumes from its top 5 customers and the signing of a license agreement with Easy Industries dated and effective January 1, 2008, which contributed to the increase in sales overall. The license agreement resulted in $1,111,000 in sales for the nine months ended August 31, 2008. The Company continues its strategic focus on 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.

The Singapore royalty agreement generated gross profit of $0 and $476,985 for the nine month periods ended August 31, 2008 and 2007, respectively. Net income attributable to this agreement was $0 and $429,286 for the nine-month periods ended August 31, 2008 and 2007, respectively. The Company is currently involved in litigation with Foamtec arising out of a dispute associated with the final payment to the Company under the royalty agreement. See Part II - Other Information, Item 1: Legal Proceedings, for further information.

Cost of goods sold for the nine months ended August 31, 2008 and 2007 were $6,883,755 and $6,251,782, respectively. The Company's gross profit margin was 24% in the nine months ended August 31, 2008, compared to 22% in the 2007 comparable period. The increase in costs of goods sold results from the increase in raw material and freight costs. The Company's top five customers products are foam based products, which are petroleum-based products, and we continue to see increases in raw material and freight costs due to increases in costs of petroleum.

Selling, general and administrative expenses for the nine months ended August 31, 2008 and 2007 were $1,808,237 and $1,294,320, respectively, representing an increase of $513,917 or 40%. These costs increased over the previous year due to additional staff added in sales, quality control and the addition of staff to fulfill the Miss Oops® product line. The Company obtained ISO 13485 certification in 2007 and is currently pursuing the ISO AS9100 certification in order to allow the Company to bid for business within the Aerospace Industry. The Company also has added customer service staff to further its commitment to service our customers with the upstart of the fulfillment services business that began in the third quarter of 2008.

Interest expense for the nine months ended August 31, 2008 and 2007 was $76,545 and $66,290, respectively. Interest expense relates primarily to bank borrowings and will increase or decrease based on interest rate fluctuations.

The Company recorded an income tax benefit of $11,277 in the nine months ended August 31, 2008. This benefit was mainly a result of the Company recording a deferred tax asset related to stock based compensation.

Net income for the nine months ended August 31, 2008 was $246,603 compared to $534,882 for the same period in 2007. Basic and diluted net income per share for the nine months ended August 31, 2008 was $0.02 per share, compared to $0.04 per share for the same period in 2007.

LIQUIDITY AND CAPITAL RESOURCES

As of August 31, 2008, we had working capital of $2,495,848 compared to working capital of $2,820,805 at November 30, 2007.

Cash and cash equivalents were $325,165 at August 31, 2008, compared with $462,701 at November 30, 2007. Operating activities used $1,120,587 of cash during the nine months ended August 31, 2008, compared with cash used of $267,848 in the corresponding period of fiscal 2007. The cash used by operating activities in the nine months ended August 31, 2008 resulted primarily from net income of $246,603 plus non-cash charges of $109,763, an increase in accounts receivable of $1,090,989, an increase in inventory of $593,127, a decrease in prepaid expenses of $192,281 and an increase in accounts payable and accrued liabilities of $14,882.

Capital expenditures were $25,683 for the nine months ended August 31, 2008, compared to $284,843 for the corresponding period in fiscal 2007.

The Company uses short- and long-term borrowings to supplement internally generated cash flow. Activity related to short- and long-term borrowings in the nine months ended August 31, 2008 resulted in cash provided by financing activities of $1,008,734 compared to cash provided by financing activities of $317,869 in the same period of 2007.

On March 1, 2007, AMG, through its wholly-owned subsidiary AMI, obtained a $2,000,000 credit facility from JPMorgan Chase Bank, N.A. (“Lender”). The Credit Facility was established pursuant to a Credit Agreement between AMI and Lender and evidenced by a Line of Credit Note executed by AMI. This Line of Credit Note was amended on July 14, 2008 to extend the credit facility (the “Credit Facility”) to $2,500,000. The proceeds under the Credit Facility will be used primarily for working capital needs in the ordinary course of business.

AMI can borrow, pay and reborrow principal under the Credit Facility from time to time during its term, but the outstanding principal balance under the Credit Facility may not exceed the lesser of the borrowing base or $2,500,000. For purposes of the Credit Facility, “borrowing base” is calculated by adding 80% of AMI's eligible accounts receivable to 50% of the lower of cost or wholesale market value of all of AMI's eligible inventory.

The outstanding principal balance under the Credit Facility bears interest at the rate of interest per annum announced from time to time by the Lender as its prime rate, and will be computed on the unpaid principal balance from the date of each borrowing. Accrued interest payments on the unpaid principal balance under the Credit Facility are payable quarterly commencing on May 1, 2007, and all outstanding principal under the Credit Facility, together with all accrued but unpaid interest, is due at maturity, which has been extended until April 1, 2009.

The Credit Facility is secured by a first priority lien on all of AMI's currently owned and subsequently acquired accounts receivable, chattel paper, deposit accounts, documents, equipment, general intangibles, instruments, inventory, investment property and letter of credit rights pursuant to a Continuing Security Agreement between AMI and Lender.

The Credit Agreement contains certain covenants with which AMI must comply. Subject to Lender's consent, AMI is prohibited under the Credit Agreement from, among other things, declaring or paying dividends on its capital stock, issuing, selling or otherwise disposing of any shares of its capital stock and incurring, assuming or permitting to remain outstanding any indebtedness for borrowed money, subject to certain exceptions. Additionally, AMI is prohibited from engaging in any business activities substantially different from those in which it is currently engaged and from merging or consolidating with any other entity or selling any of its assets outside of the ordinary course of business.

The line of credit agreement requires the Company to maintain certain financial covenants including maintaining tangible net worth no less than $1,500,000 as of each fiscal quarter end.

If a default occurs under the Credit Agreement, the Line of Credit Note or any other related documents, Lender may declare all amounts outstanding under the Credit Facility immediately due and payable. In such event, Lender may exercise any rights and remedies it may be provided by law or agreement, including the ability to cause all or any part of the collateral under the Continuing Security Agreement to be transferred to Lender or registered in Lender's or any other designated entity's name. Any such event may materially impair AMI's and the Company's ability to conduct its business.

Borrowings outstanding under the Line of Credit at August 31, 2008 were $2,200,000.

FACTORS THAT COULD AFFECT FUTURE RESULTS

COSTS OF PETROLEUM-BASED RAW MATERIALS

The costs of raw materials, which primarily includes petroleum-based products such as foam, account for an average of 54% or more of our manufacturing costs. We have experienced increases in raw material costs since the middle of 2002. Our ability to pass on cost increases may be hindered by competition or selling price. Prices of raw materials are influenced by demand, manufacturing capacity and oil and natural gas prices. Historically, the prices of raw materials have been cyclical and volatile and our suppliers of raw materials have increased the price of raw materials several times over the past years. We have been successful in implementing fixed price contracts for raw materials for our largest customers and retaining our customer base; however, we may not be able to pass along all costs to our customers in the future, which could impact our profitability.

BANKING

AMI obtained a Credit Facility in the second quarter of fiscal 2007. This credit agreement has been extended until April 1, 2009. The credit agreement evidencing the Credit Facility requires AMI to maintain certain financial covenants as outlined in the Credit Agreement. Failure to meet these financial covenants could result in increased borrowing costs. The Credit Facility is secured by a first priority lien on all of AMI's currently owned and subsequently acquired accounts receivable, chattel paper, deposit accounts, documents, equipment, general intangibles, instruments, inventory, investment property and letter of credit rights pursuant to a Continuing Security Agreement between AMI and Lender. If a default occurs under the documents evidencing the Credit Facility, Lender may declare all amounts outstanding under the Credit Facility immediately due and payable. In such event, Lender may exercise any rights and remedies it may be provided by law or agreement, including the ability to cause all or any part of the collateral under the continuing Security Agreement to be transferred to Lender or registered in Lender's or any other designated entity's name. Any such event may materially impair AMI's and the Company's ability to conduct its business.

CUSTOMER CONCENTRATION

The Company realizes 60% or more of its revenues from five customers. Any loss of business from these customers could have a significant impact on the Company's financial position.

NEW PRODUCT INTRODUCTIONS

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

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 significant 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. Any of these factors, if realized, could reduce the Company's profitability and operating results.

EARTHQUAKE

The AMI manufacturing division in California is 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.

INTELLECTUAL PROPERTY

The Company's success will depend, in part, on its ability to obtain and enforce intellectual property protection for our technology in both the United States and other countries. Although the Company has been issued certain patents, it has also filed patent applications in the United States Patent and Trademark Office with respect to certain patents that have not yet been issued. The Company cannot provide any assurance that patents will issue from these applications or that, with respect to any patents, issued or pending, the claims allowed are, or will be, sufficiently broad to protect the key aspects of our technology, or that the patent laws will provide effective legal or injunctive remedies to stop any infringement of its patents. In addition, the Company cannot assure investors that any owned patent rights will not be challenged, invalidated or circumvented, that the rights granted under patents will provide competitive advantages, or that competitors will not independently develop or patent technologies that are substantially equivalent or superior to our technology. The Company's business plan assumes that it will obtain and maintain comprehensive patent protection of its technologies. The Company cannot assure investors that such protection will be obtained, or that, if obtained, it will withstand challenge. Furthermore, if an action is brought, a court may find that the Company has infringed on the patents owned by others. The Company may have to go to court to defend its patents, to prosecute infringements, or to defend infringement claims made by others. Patent litigation is expensive and time-consuming, and well-funded adversaries can use such actions as part of a strategy for depleting the resources of a small company such as AMI. The Company cannot assure investors that we will have sufficient resources to successfully prosecute our interests in any litigation that may be brought.

LIQUIDITY

Our common stock trades in the United States only on the Pink Sheets, which is a reporting service and not a securities exchange. We cannot assure investors that in the future our common stock will ever qualify for inclusion on any of the NASDAQ markets, the American Stock Exchange or any other national exchange or that more than a limited market will ever develop for our common stock. The lack of an orderly market for our common stock may negatively impact the volume of trading and market price for our common stock.

Historically, the volume of trades for our stock has been limited. Moreover, thus far the prices at which our common stock has traded have fluctuated fairly widely on a percentage basis. The trading activity in our common stock should be considered sporadic, illiquid and highly volatile.

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.

ITEM 3 - CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and President/Chief Financial Officer (the Company's principal executive officer and principal financial officer), have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the period ended August 31, 2008, the period covered by this Quarterly Report on Form 10-QSB. Based upon that evaluation, the Company's principal Chief Executive Officer and Chief Financial Officer have concluded that as of August 31, 2008, the Company’s disclosure controls and procedures provide reasonable assurance that material information relating to the Company is made known to management, including our Chief Executive Officer and Chief Financial Officer.

There were no changes in the Company's internal control over financial reporting that occurred during the period ended August 31, 2008 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

On or about October 18, 2007, the Company filed suit in the Superior Court of the State of California, County of Orange, Central Justice Center, against Foamtec (Singapore) Pte. Ltd., a private limited company incorporated in Singapore, and Foamex Asia Ltd., a private company incorporated in Burma, formerly the Kingdom of Thailand (collectively, “Foamtec”). In December of 1998, the Company and Foamtec entered into a Manufacturing Agreement, whereby the Company and Foamtec agreed to work cooperatively to manufacture and sell certain foam components to Hewlett Packard Company and certain other buyers. As part of the Manufacturing Agreement, Foamtec agreed to act as fiduciary agent for the Company in distributing the manufactured product to Hewlett Packard, its successors and assigns. The term of the Manufacturing Agreement was for ten years, which could be extended by either party for an additional five years. Foamtec had the option to purchase the Company’s interest in the Manufacturing Agreement by paying a price to be calculated on the profits expected under the entire remaining term which, by definition, included its entire term, including the additional five years if the Company exercised its extension right. In 2006, the Company gave notice to Foamtec of its election to extend the term of the Manufacturing Agreement for an additional five years in accordance with its rights under the Manufacturing Agreement. Thereafter, Foamtec gave notice of its election to purchase the Company’s interest in the Manufacturing Agreement, and tendered certain funds in claimed discharge of its payment obligations thereunder. Foamtec asserted that this payout right only applied to the initial term, and not the extended term, and therefore remitted funds that represented the expected profits through the end of the initial term. The Company therefore sued Foamtec for breach of contract for Foamtec’s failure to pay the Company the amount of expected profits for the extended term, as well as for breach of fiduciary duty. The Company is seeking compensatory damages in excess of $1,000,000, exemplary damages in an amount subject to proof, interest as provided by law and costs associated with the suit.

The Company may from time to time be involved in other legal proceedings in the normal course of operations and are incidental to its business. Although the outcome of the proceedings cannot be determined, in the opinion of management, based on discussions with and advice of legal counsel, any resulting future liability from such proceedings, either individually or in the aggregate, will not adversely affect the Company.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

NONE

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

NONE

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

NONE

ITEM 5. OTHER INFORMATION.

NONE

ITEM 6. EXHIBITS

(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

31.2 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

32.2 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

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: October 15, 2008
ADVANCED MATERIALS GROUP, INC.

/s/ Ricardo G. Brutocao
Ricardo G. Brutocao
Chief Executive Officer

/s/ William G. Mortensen
William G. Mortensen
President and Chief Financial Officer

EXHIBIT 31.1

CERTIFICATIONS

I, Ricardo G. Brutocao, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Advanced Materials Group, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4. The small business issuer's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) [language omitted pursuant to SEC Release 34-47986] for the small business issuer and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) [Omitted pursuant to SEC Release 34-47986];

(c) Evaluated the effectiveness of the small business issuer’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the small business issuer’s internal control over financial reporting that occurred during the small business issuer’s most recent fiscal quarter (the small business issuer’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer’s internal control over financial reporting; and

5. The small business issuer’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer’s auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer’s internal control over financial reporting.

Date: October 15, 2008

/s/ RICARDO G. BRUTOCAO
Ricardo G. Brutocao
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATIONS

I, William G. Mortensen, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Advanced Materials Group, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4. The small business issuer's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) [language omitted pursuant to SEC Release 34-47986] for the small business issuer and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) [Omitted pursuant to SEC Release 34-47986];

(c) Evaluated the effectiveness of the small business issuer’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the small business issuer’s internal control over financial reporting that occurred during the small business issuer’s most recent fiscal quarter (the small business issuer’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer’s internal control over financial reporting; and

5. The small business issuer’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer’s auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer’s internal control over financial reporting.

Date: October 15, 2008

/s/ WILLIAM G. MORTENSEN
William G. Mortensen
President and Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report on Form 10-QSB of Advanced Materials Group, Inc. (the "Company") for the quarter ended May 31, 2008 (the "Report"), the undersigned hereby certifies, pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. the information contained in the Report fairly presents, in all material respects, as of, and for, the periods presented in the report, the consolidated financial condition and results of operations of the Company.

Dated: October 15, 2008

By: /s/ RICARDO G. BRUTOCAO
Ricardo G. Brutocao
Chief Executive Officer

EXHIBIT 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report on Form 10-QSB of Advanced Materials Group, Inc. (the "Company") for the fiscal quarter ended May 31, 2008 (the "Report"), the undersigned hereby certifies, pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. the information contained in the Report fairly presents, in all material respects, as of, and for, the periods presented in the report, the consolidated financial condition and results of operations of the Company.

Dated: October 15, 2008

By: /s/ WILLIAM G. MORTENSEN
William G. Mortensen
President and Chief Financial Officer