

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

**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-K/A  
Amendment No. 1**

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

**For the fiscal year ended August 31, 2006**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

Commission File Number 0-13851

**NITCHES, INC.**

(Exact name of registrant as specified in its charter)

**California**  
(State of Incorporation)

**95-2848021**  
(I.R.S. Employer Identification No.)

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

**92121**  
(Zip Code)

Registrant's telephone number: (858) 625-2633

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

**Title of each class**  
Common Stock, no par value

**Name of each exchange on which registered**  
NASDAQ Capital Market

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in rule 12b-2 of the Exchange Act). Yes  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.

As of November 30, 2006, 5,253,507 shares of the Registrant's common stock were outstanding.

The aggregate market value of all equity securities held by non-affiliates of the Registrant as of the last business day of the most recently completed second fiscal quarter (February 28, 2006) based on the closing price of the Registrant's stock in the NASDAQ Capital Market on that date was \$30,806,653.

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### EXPLANATORY NOTE

We filed our Annual Report on Form 10-K for the year ended August 31, 2006 (the "Original Filing") with the Securities and Exchange Commission on December 14, 2006. In that Original Filing we stated under Part II, Item 9A that, in the opinion of our chief executive and financial officer, our disclosure controls and procedures contained a deficiency that impeded our ability to timely process and report information. We also discussed certain limitations concerning the efficacy of any disclosure controls and procedures. We are filing this Amendment No. 1 on Form 10-K/A to provide additional detail concerning the nature of that deficiency and our efforts to remediate that deficiency, and to revise our disclosure concerning the inherent limitations of disclosure controls and procedures.

This Amendment No. 1 on Form 10-K/A amends and restates "Item 9A. Controls and Procedures," of our Original Filing, solely as a result of, and to reflect, the impact of the items discussed in this Explanatory Note. While we have presented our complete financial statements with this Amendment No. 1 on Form 10-k/A, those financial statements remain unchanged from the Original Filing.

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

## PART I

### Item 1 - Business

#### *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.

#### *General*

Nitches, Inc. (the "Company" or "Nitches") designs, markets, contracts for the manufacture of, and distributes wholesale apparel to national retailers, regional chain stores and specialty retailers. Product offerings include men's casual lifestyle clothing by Newport Blue®, men's golf apparel by The Skins Game®, women's sleepwear under retailers private labels, women's western wear by Adobe Rose® and Southwest Canyon®, and women's private label apparel and Saguaro® outerwear. The Company provides fashionable clothing to the popularly priced market segment that generally retails between \$10 and \$35 per item. For 35 years the Company has competed on the basis of price, quality, the desirability of its fabrics and designs, and the reliability of its delivery and service.

The apparel market continues to be marked by deflation and modest profit margins in many markets. The consolidation of retail stores among a small number of national chains has given these chains leverage to seek lower pricing and thereby reduce profit margins for suppliers such as Nitches. In recent years, many vertical retailers who design, produce and sell their own product direct to consumers through physical stores, catalogs and the internet have emerged or expanded. Management has responded by developing products in categories

that are underserved or where the Company retains an advantage in sources of supply, design or distribution. Management has also sought alliances and acquisitions as a means to increase sales to new and existing customers and improve margins by achieving operational efficiencies across a broader product portfolio.

### ***Recent Developments***

As of October 24, 2005, the Company also owns Designer Intimates, Inc., a New York City based importer and distributor of both branded and private label women's sleepwear, robes, loungewear, swimwear and intimate apparel; men's sleepwear, robes, and loungewear; and infant's and children's sleepwear and robes. With the Designer Intimates acquisition, the Company has become a diversified supplier of women's intimate apparel at multiple levels of retail distribution. The purchase added significant revenues, further strengthened the Company's product mix, and added to the Company's portfolio of brands.

Additionally, on July 1, 2006 the Company acquired the Home Décor business of Taresha LLC. Home Décor products include candles, candle holders and other home decorating accessories. Home Décor products are sold under the Bill Blass, Michael Coffindaffer and Newport Blue brands primarily to the same retailers as Nitches' apparel products. The purchase added new sources of revenue and diversified the Company's product offerings to retailers beyond apparel.

Finally, on October 24, 2006, Nitches completed its acquisition of the Saguaro® mark and related trademarks from Impex Inc., a leading manufacturer of branded and non-branded specialty, western and private-label women's apparel. Since January 2005, the Company had been manufacturing and distributing Saguaro® apparel products to specialty and catalog retailers under the terms of a strategic alliance with Impex. This purchase secured a growing revenue base and eliminated royalties and design fees that Nitches had previously paid to Impex under the terms of a strategic alliance.

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### ***Product Development and Design***

The in-house design and merchandising staff of Nitches develops high quality lines of clothing for each of the Company's brands. Using computer-based design and illustration technology, designers create original garment bodies (styles) with unique fabric prints and designs. The Company also may incorporate prints and concepts purchased from freelance artists and independent design services. The use of advanced design tools allows the Company to simulate a wide variety of product for development and presentation to retailers on printed storyboards and in catalogs. The time and expense of sample production is thereby avoided or reduced as merchandisers narrow and refine product lines.

Nitches responds to frequent style changes in women's and men's clothing by maintaining a program of evaluating current trends in style and fabric. In an effort to continually stay abreast of fashion trends, Company representatives shop at 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 may also seek input from selected customers and other industry resources. Design teams then select styles, fabrics, and colors that interpret current fashion trends for their respective product lines.

Retail store buyers may also provide specifications to the Company or may select for sale through their private label apparel programs styles from product lines Nitches' designers have developed. The Company then manufactures and imports these goods which are generally sold under a label owned by or exclusive to a retailer. Retailers rely on the established reputation of the Company for arranging for foreign manufacture on a reliable, expeditious and cost-effective basis.

### ***Sources of Supply***

Over 98% 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

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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 specific needs.

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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, 2006, 2005, and 2004.

Percent of Total Purchases by Country

|  | Year ended August 31, |       |       |
|--|-----------------------|-------|-------|
|  | 2006                  | 2005  | 2004  |
| China                                    | 22.7                  | 2.7   | -     |
| Macau                                    | 13.7                  | -     | -     |
| Turkey                                   | 13.3                  | -     | -     |
| Cambodia                                 | 12.8                  | 36.4  | 27.6  |
| India                                    | 9.7                   | 16.7  | 18.8  |
| Hong Kong                                | 9.3                   | 15.4  | 7.1   |
| Pakistan                                 | 7.8                   | 16.4  | 16.5  |
| Dubai/UAE                                | 2.8                   | -     | -     |
| Sri Lanka                                | 2.3                   | 5.7   | 13.6  |
| United States                            | 1.8                   | 4.9   | 14.5  |
| Oman                                     | 1.1                   | -     | -     |
| Countries <1.0% each in the current year | 2.7                   | 1.8   | 1.9   |
|  | 100.0                 | 100.0 | 100.0 |

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 works with independent agents specializing in sourcing and production control in Cambodia, China, India, Pakistan, Sri Lanka and Turkey. The Company and its subsidiary 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.

### **Raw Materials**

The clothing sold by the Company is made of 100% cotton, cotton blends, polyester, rayon and leather 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 majority of the fabrics that the Company use comes from multiple sources of supply in many countries including China, Pakistan and India. The Company is not dependent on a single source of supply for fabric that is not readily replaceable.

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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. Employees in Company showrooms in New York City and Los Angeles represent the Company in soliciting orders nationally. In addition, senior managers of the Company have primary responsibility for sales to certain key accounts. The Company's products are also marketed by approximately 54 independent commissioned sales representatives.

The presence of a national brand has emerged as a principle factor in apparel buying decisions. In response, the Company has sought ownership or control of recognized brands for the categories of apparel which it distributes. Through Designer Intimates, the Company markets sleepwear, robes, loungewear, and daywear under the following brands: Derek Rose®, Princesse tam tam®, Crabtree & Evelyn®, Disney Couture®, The Anne Lewin® Collection, The Bill Blass® Lifestyle Collection, The Claire Murray® Collection and Gossard®. The Company designs and distributes men's wear under the Newport Blue® and The Skins Game® labels through agreements with third parties. The Company distributes women's Western wear shirts under its own labels Adobe Rose® and Southwest Canyon®. Western jeans are sold under the label Posted® through a licensing agreement with a third party supplier. We also import and distribute women's sweaters and Saguario® leather outerwear under an agreement with a third party.

Most garments are shipped by suppliers in bulk form to the Company's warehouses in San Diego and New Jersey, 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. In the past the Company has 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. Yet 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 three customers accounted for 21.6%, 10.9% and 11.2% respectively, of the Company's net sales during fiscal 2006. One customer accounted for 53.1% of the Company's net sales in fiscal 2005. 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 alter 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.

### ***Imports and Import Restrictions***

The ability of the Company to import garments is subject to the risks of international commerce. Imports into the United States are affected by, among other things, the cost of transportation and import restrictions that limit the specific number of garments that may be imported from any country during a specific period. Countries from which the Company purchases garments may impose or alter quotas, duties or other restrictions on substantially all of the products imported by the Company. Because of this uncertainty, the Company has sought diversity in the number of countries in which it has garments manufactured.

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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. 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, 2006 and August 31, 2005 the Company had unfilled customer orders of \$44.7 million and \$9.9 million, respectively, with such orders generally scheduled for delivery by March 2007 and 2006, respectively. The increase in backlog of \$34.8 million is due to the addition of \$16.2 million in orders as a result of the acquisition of Designer Intimates, \$3.2 million from the acquisition of the Home Décor product line, and a \$15.4 million increase in orders for Nitches' women's sleepwear and men's and women's sportswear lines. The amount of unfilled orders at any given time is affected by a number of factors, including the timing of the receipt and processing of customer orders and the scheduling of the manufacture and shipping of the product, which may be dependent on customer requirements.

As of November 30, 2006, the Company had on-hand unfilled customer orders of \$26.4 million as compared to \$12.3 million at November 30, 2005, with such orders generally scheduled for delivery by May 2007 and 2006, respectively. The increase in backlog of \$14.1 million is due to the addition of \$7.8 million in orders as a result of the acquisition of Designer Intimates, \$1.4 million from the acquisition of the Home Décor product line, and \$4.9 million increases in orders for Nitches' women's sleepwear and sportswear lines. Backlog 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 either August 31, 2006 or November 30, 2006.

## **Competition**

The apparel industry 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. Increasingly the Company competes directly with agents or with retailers' own sourcing affiliates who own factories or have established production relationships that allow these companies to directly supply retailers with the desired product at a lower cost.

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## **Employees**

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. As of August 31, 2006, the Company had 82 full-time employees, of whom 12 worked in executive, administrative or clerical capacities and 62 worked in sales, design, and production. Additionally, the Company employs eight individuals in its Hong Kong office who are responsible for fabric and trim sourcing, product development and quality control. The Company contracts with an unrelated entity to provide warehouse services. 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.

## **Acquisitions**

### **Designer Intimates**

On October 1, 2002, the Company acquired a 28% interest in Designer Intimates, Inc., which owns 100% of NAP, Inc. (NAP), a New York-based intimate apparel company. NAP is a leading designer, marketer and distributor of women's sleepwear, robes, loungewear, daywear and foundations in the United States. Designer Intimates acquired NAP from its founders and obtained a credit line of approximately \$12 million from HSBC which was later assumed by CIT that is secured by the inventory and accounts receivable of NAP and the guarantees of shareholders of Designer Intimates. The Company guaranteed \$3.0 million of this credit line and this guaranty formed the consideration from the company for its 28% ownership interest in Designer Intimates.

On October 24, 2005, the Company acquired the remaining seventy-two percent (72%) of the issued and outstanding stock of Designer Intimates, Inc., a Delaware corporation (Designer Intimates) which Nitches did not own, resulting in the Company owning one hundred percent (100%) of Designer Intimates. The aggregate purchase price for the acquisition was \$1,800,000. Nitches issued to the Sellers 180,000 restricted shares of its common stock at a value of \$5.10 per share and \$882,000 of preferred stock. The acquired assets of Designer Intimates included finished goods inventory, customer lists, customer orders, trade names, brand licenses, brand distribution agreements, office leases in New York City and Atlanta, and office equipment, furniture and fixtures, all of which Nitches continues to use.

### **Home Décor**

On July 1, 2006 the Company acquired the Home Décor business of Taresha LLC for 600,000 shares of Nitches common stock at a purchase price of \$2,730,000. Assets acquired included inventory, order backlog, customer lists, licenses and license agreements. As part of the transaction Nitches will retain all key executives in product development, sales and production. The Home Décor business involves the design, sale, and distribution of made-to-order candles, candle holders and other home decorating accessories. These products are sold under the Bill Blass, Michael Coffindaffer and Newport Blue brands primarily to the same retailers as Nitches' apparel products.

## Saguaro

On October 24, 2006, Nitches completed its acquisition of the Saguaro® mark and related trademarks from Impex Inc., a leading manufacturer of branded and non-branded specialty, western and private-label women's apparel. Consideration paid to Impex was in the form of 600,000 shares of Nitches common stock and a \$300,000 promissory note for a total purchase price of \$3,030,000. Since January 2005, the Company had been manufacturing and distributing Saguaro® apparel products to specialty and catalog retailers under the terms of a strategic alliance with Impex. Under this alliance, Nitches recorded the revenue from such sales and remitted royalties and design fees to Impex as part of its operating expenses. As of the closing of the Acquisition Agreement, Nitches is no longer required to pay such fees to Impex. Accordingly, profit margins for Saguaro® products are expected to increase.

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### Item 1A Risk Factors

#### Certain Business Risk Factors

***We rely on a few key customers, and the loss of any one key customer would substantially reduce our revenues.***

We derive a significant amount of our revenues from a few major customers. A significant decrease in business from or loss of any of our major customers could harm our financial condition by causing a significant decline in revenues attributable to such customers.

The Company's business is concentrated on certain significant customers. Sales to three customers accounted for 21.6%, 10.9% and 11.2% respectively, of the Company's net sales during fiscal 2006. One customer accounted for 53.1% of the Company's net sales in fiscal 2005. While the Company believes its relationships with its major customers are good, we do not have long-term contracts with any of them and purchases generally occur on an order-by-order basis. Because of competitive changes and the availability of the types of garments sold by the Company from a number of other suppliers, there is the possibility that any customer could alter 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 orders from other major customers, there could be a material adverse financial effect on the Company.

***Our business depends on consumer spending patterns.***

Our business is sensitive to a number of factors that influence the levels of consumer spending, including political and economic conditions such as recessionary environments, the levels of disposable consumer income, consumer debt, interest rates and consumer confidence. Reduced consumer spending on apparel and accessories could have an adverse effect on our operating results.

***We operate in a highly competitive and fragmented industry and our failure to successfully compete could result in a loss of one or more significant customers.***

The retail apparel industry is highly competitive and fragmented. Our competitors include numerous apparel designers, manufacturers, importers and licensors, many of which have greater financial and marketing resources than us. We believe that the principal competitive factors in the apparel industry are:

- timeliness, reliability and quality of services provided,
- pricing that supports retailers' targeted gross margins,
- brand name and brand identity, and
- the ability to anticipate customer requirements and consumer demand.

If we do not continue to provide high quality and reliable services on a timely basis at competitive prices, we may not be able to continue to compete in our industry. If we are unable to compete successfully, we could lose one or more of our significant customers which, if not replaced, could negatively impact our sales and financial



performance.

***We must successfully gauge fashion trends and changing consumer preferences to succeed.***

Our failure to anticipate, identify and respond effectively to changing consumer demands and fashion trends could adversely affect acceptance of our products by retailers and consumers and may result in a significant decrease in net sales or leave us with a substantial amount of unsold inventory. We believe that our success depends on our ability to anticipate, identify and respond to changing fashion trends in a timely manner. Our products must appeal to a broad range of consumers whose preferences cannot be predicted with certainty and are subject to rapid change. If our products are not successfully received by retailers and consumers and we are left with a substantial amount of unsold inventory, we may be forced to rely on markdowns or promotional sales to dispose of excess, slow-moving inventory. If this occurs, our business, financial condition, results of operations and prospects may be harmed.

***We depend on our key personnel.***

Our success depends to a large extent upon the continued services of our officers and managers. The loss of the services of any key member of management could have a material adverse effect on our ability to manage our business. Our continued success is dependent upon our ability to attract and retain qualified management, administrative and sales personnel to support our future growth. Our inability to do so may have a significant negative impact on our ability to manage our business.

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**Item 2 - Properties**

The Company currently leases properties in California, Georgia, Hong Kong and New York,. The Company leases one showroom in New York City, one in Los Angeles, one in Atlanta and approximately 30,000 square feet of warehouse with administrative offices in San Diego. The Company contracts for warehouse and office space in New Jersey under a service agreement. The Company may lease additional short-term warehouse space from time to time as needed.

**Item 3 - Legal Proceedings**

None.

**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 2006.

**PART II**

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

The Company's Common Stock trades on The NASDAQ Capital Market under the symbol NICH. The number of shareholders of record of Nitches' Common Stock on November 30, 2006 was 92. 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 November 30, 2006 was \$6.09 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:

|  | <b>High</b> | <b>Low</b> |
|--|-------------|------------|
| <b>FISCAL YEAR ENDED AUGUST 31, 2006</b> |             |            |
| First Quarter                            | \$ 1.80     | \$ 1.67    |

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|                |      |      |
|----------------|------|------|
| Second Quarter | 7.94 | 1.63 |
| Third Quarter  | 8.64 | 4.53 |
| Fourth Quarter | 6.03 | 3.09 |

**FISCAL YEAR ENDED AUGUST 31, 2005**

|                |         |         |
|----------------|---------|---------|
| First Quarter  | \$ 2.39 | \$ 1.76 |
| Second Quarter | 2.22    | 1.40    |
| Third Quarter  | 1.74    | 1.20    |
| Fourth Quarter | 1.76    | 1.45    |

The Company does not have a quarterly dividend policy and did not pay or declare any cash dividends during fiscal year 2006 and 2005. On January 20, 2006 the Company issued a 200% stock dividend to shareholders of record as of January 3, 2006. This stock dividend had the effect of tripling the outstanding number of shares of the Company.

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

**OPERATING RESULTS DATA:**

|   | Fiscal Year Ended August 31,             |            |           |           |           |
|---|--|------------|-----------|-----------|-----------|
|   | 2006                                     | 2005       | 2004      | 2003      | 2002      |
|   | (In thousands, except per share amounts) |            |           |           |           |
| Net sales   | \$ 54,832                                | \$ 26,320  | \$ 32,179 | \$ 28,440 | \$ 29,589 |
| Cost of goods sold                                | 39,985                                   | 20,534     | 22,783    | 21,856    | 22,214    |
| Gross profit                                      | 14,847                                   | 5,786      | 9,396     | 6,584     | 7,375     |
| Selling, general and administrative               | 13,763                                   | 8,175      | 8,389     | 7,663     | 7,132     |
| Income (loss) from operations                     | 1,084                                    | (2,389)    | 1,007     | (1,079)   | 243       |
| Other income                                      | 2  | 460        | --        | 3         | 16        |
| Interest expense                                  | (486)                                    | (102)      | (93)      | (83)      | (80)      |
| Net income (loss) from equity investment          | (11)                                     | (64)       | 14        | (236)     | --        |
| Income (loss) before income taxes                 | 589                                      | (2,095)    | 928       | (1,395)   | 179       |
| Provision for (benefit from) income taxes         | 121                                      | (894)      | 371       | (425)     | 63        |
| Net income (loss)                                 | \$ 468                                   | \$ (1,201) | \$ 557    | \$ (970)  | \$ 116    |
| Basic earnings per share                          | \$ 0.11                                  | \$ (0.34)  | \$ 0.16   | \$ (0.28) | \$ 0.03   |
| Diluted earnings per share                        | \$ 0.11                                  | \$ (0.34)  | \$ 0.16   | \$ (0.28) | \$ 0.03   |
| Cash dividends per common share                   | \$ --                                    | \$ --      | \$ --     | \$ 0.10   | \$ 0.15   |
| Weighted average number of common shares (000's): |  |            |           |           |           |
| Basic   | 4,077                                    | 3,514      | 3,514     | 3,514     | 3,336     |
| Diluted   | 4,077                                    | 3,514      | 3,514     | 3,514     | 3,336     |

**CONSOLIDATED BALANCE SHEETS DATA:**

|   | As of August 31 |          |          |          |          |
|---|-----------------|----------|----------|----------|----------|
|   | 2006            | 2005     | 2004     | 2003     | 2002     |
|   | (In thousands)  |          |          |          |          |
| Cash                                    | \$ 228          | \$ 192   | \$ 219   | \$ 110   | \$ 182   |
| Receivables                             | 10,559          | 4,233    | 5,526    | 922      | 4,523    |
| Income taxes receivables                | --              | 212      | --       | 466      | 118      |
| Inventories                             | 12,424          | 4,582    | 3,373    | 4,974    | 5,306    |
| Total current assets                    | 24,426          | 10,388   | 9,495    | 6,721    | 10,378   |
| Total assets                            | 30,784          | 10,453   | 9,561    | 6,847    | 10,503   |
| Accounts payable and accrued expenses   | 20,277          | 6,047    | 3,878    | 1,707    | 4,277    |
| Total current liabilities               | 20,790          | 6,047    | 3,878    | 1,707    | 4,277    |
| Shareholders' equity                    | \$ 9,258        | \$ 4,260 | \$ 5,461 | \$ 4,904 | \$ 6,226 |
| <b>Other Financial Information:</b>     |                 |          |          |          |          |
| Gross margin                            | 27.1%           | 22.0%    | 29.2%    | 23.2%    | 24.9%    |
| Operating margin (deficit)              | 2.0%            | (9.1%)   | 3.1%     | (3.8%)   | 0.8%     |
| Net income (loss) as a percent of sales | 0.9%            | (4.6%)   | 1.7%     | (3.4%)   | 0.4%     |
| <b>Liquidity:</b>                       |                 |          |          |          |          |
| Current ratio                           | 1.17            | 1.72     | 2.45     | 3.94     | 2.43     |
| Working capital                         | \$ 3,636        | \$ 4,341 | \$ 5,617 | \$ 5,014 | \$ 6,101 |

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**Item 7 - Nitches, Inc and Subsidiaries Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**Cautionary Statement Under the Private Securities Litigation Reform Act of 1995**

Statements in the annual report on Form 10-K under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations", 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, among others, a softening of retailer or consumer acceptance of the Company's products, pricing pressures and other competitive forces, 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.

**Critical Accounting Policies**

Several of the Company's accounting policies involve significant judgments and uncertainties. The policies with the greatest potential effect on the Company's results of operations and financial position include the estimated collectibility of accounts receivable and the recovery value of obsolete or overstocked inventory.

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

*Allowances for Sales Returns, Doubtful Accounts and Other.* Sales are recorded net of estimated future returns, uncollectible accounts receivable and other customer related allowances. Management analyzes historical returns and bad debt expense, current economic trends, changes in customer demand and sell-through of our products when evaluating the adequacy of these allowances. In addition, the Company may provide warehousing credits and other allowances to certain customers in accordance with industry practice. These reserves are determined based on historical experience, budgeted customer allowances and existing commitments to customers. Although management believes it has established adequate reserves with respect to these items, actual activity could vary from management's estimates and such variances could have a material impact on reported results.

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

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## **Results of Operations**

### ***Years Ended August 31, 2006 and 2005***

Net sales for the fiscal year ended August 31, 2006 increased \$28.5 million or 108.3% as compared to the prior fiscal year ended August 31, 2005. This increase was primarily attributable to the acquisition of Designer Intimates early in the current year. Increased shipments of the Company's sleepwear and menswear product lines as well as the addition of private label women's sportswear also contributed to the increase.

Cost of sales as a percent of net sales decreased 5.1% generating a higher gross profit margin of 27.1% for the year ended August 31, 2006 as compared to 22.0% for prior year. The increase in gross margin came primarily as the result of the addition of higher gross margin sales from Designer Intimates, as well as higher earned gross margins in the Company's menswear product line. The Company's product mix constantly changes to reflect customer mix, fashion trends and changing seasons. Consequently gross margin is likely to vary on a quarter-to-quarter basis and in comparison to gross margins generated in prior years.

Selling, general and administrative expenses for the fiscal year ended August 31, 2006 increased \$5.6 million from a year ago, due primarily to the consolidation of selling, general and administrative costs for Designer Intimates. Selling, general and administrative expense for 2006 includes \$6.0 million of selling and merchandising expense and \$1.9 million of warehousing and distribution expense.

Other income for the fiscal year 2005 of \$460,000 included \$453,000 for the repayment of a note receivable that the Company issued related to the sale of product lines in 1995. This note had been written off by the Company in fiscal 2001 as part of a credit reorganization of the buyer. However due to improved financial performance of the buyer achieved in part through continued guidance and support from the Company, the buyer elected to repay the balance on the note.

Interest expense increased \$384,000 for the current year to \$486,000 as compared to \$102,000 for the year ended August 31, 2005. This increase was due to increased advances under the Company's factoring agreement, higher interest rates charged on those advances, and the inclusion of the interest expense of Designer Intimates.

The Company's income tax provision for the year ended August 31, 2006, reflects a \$121,000 tax expense on the Company's pretax income of \$589,000, an effective tax rate of 20.5%. This lowered tax rate is the result of the benefit of net operating loss carryforwards. The Company's income tax provision for the year ended August 31, 2005, reflects an \$894,000 tax benefit on the Company's pretax loss of \$2,031,000 before the recognized operating loss of \$64,000 from the unconsolidated subsidiary.

### ***Years Ended August 31, 2005 and 2004***

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Net sales for the fiscal year ended August 31, 2005 decreased approximately \$5.9 million or 18.2% compared to the fiscal year ended August 31, 2004. This decrease was attributable to lower unit sales of the Company's men's wear and women's sleepwear products. The men's wear decline was driven primarily by the loss of Sam's Club as a customer, offset partially by an increase in orders from Kohl's and Stein Mart, while the sleepwear decline came as a result of reduced orders from Mervyn's and the loss of Sears as a customer.

Cost of sales as a percent of net sales increased by 7.2% leading to a decrease in gross profit margin from 29.2% to 22.0% between fiscal 2004 and 2005. The decrease in gross margin came primarily as a result of the loss of higher gross margin sales (in excess of 40%) in the Company's men's wear line, which were included in the year earlier period. 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 in dollar amount from \$8.4 million in fiscal 2004 to \$8.2 million in fiscal 2005, primarily due to a decreased in sales commissions and selling related expenses in line with the reduced sales volume in the Company's men's wear product line. On a percent of net sales basis, selling, general and administrative expenses increased from 26.1% in fiscal 2004 to 31.1% in fiscal 2005, due to the decrease in sales as it relates to the fixed portion of the expenses.

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Interest expense increased \$9,000 for the current year to \$102,000 as compared to \$93,000 for the year ended August 31, 2004. This 9.7% increase was primarily due to the continued rising interest rates charged by the Company's factor, despite the reduction in advance requirements under the Company's factoring agreement in line with reduced sales and purchasing activity.

The Company's income tax provision for the year ended August 31, 2005, reflects an \$894,000 tax benefit on the Company's pretax loss of \$2,031,000 before the recognized operating loss of \$64,000 from the unconsolidated subsidiary. The Company's income tax provision for the year ended August 31, 2004, reflects a \$371,000 tax expense on pretax income of \$914,000 before the recognized operating income of \$14,000 from the unconsolidated subsidiary. The decrease in taxes is a result of lower pre-tax earnings as compared to the prior year.

### **Equity Investment**

In October 2002, the Company acquired a 28% interest in Designer Intimates, Inc., which owns 100% of NAP, Inc., a New York-based intimate apparel company. Designer Intimates had acquired NAP from its founders and obtained a credit line of approximately \$12 million from HSBC which was later assumed by CIT, secured by the inventory and accounts receivable of NAP and the guarantees of shareholders of Designer Intimates. Nitches guaranteed \$3 million of this credit line and this guaranty formed the consideration from Nitches for its 28% ownership interest in Designer Intimates.

On October 24, 2005, the Company acquired the remaining seventy-two percent (72%) of the issued and outstanding stock of Designer Intimates, Inc. Until that time, Nitches reported any income or loss from the ongoing operation of Designer Intimates using the equity method of accounting, whereby Nitches' 28% interest in Designer Intimates was reported as a single line item on the Consolidated Statement of Operations. For fiscal year ended August 31, 2005, the Company recognized a loss of \$64,000 from the unconsolidated subsidiary. This loss was reported net of tax and did not provide a tax benefit to the Company. For that same period in fiscal 2005, Designer Intimates incurred a net loss of \$228,000 on sales of \$45.7 million.

### **Liquidity and Capital Resources**

For the fiscal years ended August 31, 2006, 2005 and 2004, cash used by operating activities was approximately \$3.6 million, \$1.1 million and \$281,000. For the fiscal year ended August 31, 2006, cash used by operating activities include the effect of the balances acquired in the acquisition of Designer Intimates. Cash used in 2006 was attributed to an increase in inventory in response to increased orders for fall 2006 as well as an increase in accounts receivable due to increased sales in July and August. For the fiscal year ended August 31, 2005, in addition to the net loss, cash used by operating activities was due primarily to an increase in inventories offset partially by a decrease in accounts receivable. For the fiscal year ended August 31, 2004, cash provided by

net income was offset by an increase in accounts receivable combined with a decrease in inventories, which was in line with reduced orders for the fall of 2004.

Net cash used by investing activities during the fiscal year ended August 31, 2006 consisted of \$103,000 in acquisition related expenses and \$44,000 in purchases of office equipment offset partially by the cash balance acquired in the purchase of Designer Intimates. For the fiscal year ended August 31, 2005 net cash used by investing activities of \$168,000 was primarily for a contribution of capital to Designer Intimates. Minimal cash was used in 2005 and 2004 for the purchase of furniture and equipment used in the ordinary course of business operations.

For the fiscal years ended August 31, 2006, 2005 and 2004, cash provided by financing activities was approximately \$3.7 million, \$1.2 million, and \$397,000 respectively. For each of the fiscal years, cash provided by financing activities was attributable to advances from the Company's factor in accordance with the terms of the factoring agreement. The increase in advances from factor for 2006 was attributable to the effect of the balances acquired in the acquisition of Designer Intimates. A note payable was also utilized in the purchase of inventory in response to increased orders for fall 2006.

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Working capital decreased to \$3.6 million at August 31, 2006 as compared to \$4.3 million at August 31, 2005, due to current liabilities increasing \$700,000 more than current assets increased. Increases in both current assets and current liabilities are largely attributable to the effect of balances acquired in the acquisition of Designer Intimates. However current liabilities also increased in line with increased purchases in July and August 2006 due to increased customer orders for fall 2006. Working capital decreased to \$4.3 million at August 31, 2005 as compared to \$5.5 million at August 31, 2004, due to a rise in current liabilities of 50.4%, as well as a decline in current assets of 4.0% from prior year. Current liabilities increased in line with increased purchases in July and August 2005 as compared to the same months in 2004, which generated a higher inventory level at year end. Current assets decreased due to a lower accounts receivable balance of \$4.2 million versus \$3.6 million at the end of the prior fiscal year, which was partially offset by a rise in inventory from \$3.4 million to \$4.6 million.

The Company sells substantially all of its trade receivables to a factor (CIT) on a pre-approved, non-recourse basis. The Company attempts to make any recourse shipments on a COD basis or ensure that the customers' payments are backed by a commercial or standby letter of credit issued by the customers' bank. The amount of the Company's receivables which were recourse and were not made on a COD basis or supported by commercial or standby letters of credit at August 31, 2006 was approximately \$712,000 of which approximately \$473,000 had been collected through September 30, 2006.

Payment for non-recourse factored receivables is made at the time customers make payment to CIT or, if a customer is financially unable to make payment, within approximately 180 days of the invoice due date. Under the factoring agreement, the Company can request advances in anticipation of customer collections at CIT's prime rate (currently 8.25%) less one and one-half percent (1.5%). The amount of advances available to the Company is limited to eighty-five percent (85%) of non-recourse factored receivables.

The factoring agreement does not contain any financial covenants to which the Company must adhere. Advances are collateralized by all of the assets of the Company as well as a personal guaranty of the Company's Chairman Steven Wyandt. This guaranty allows CIT to recover up to \$1 million from Mr. Wyandt to offset any losses incurred in the event of liquidation.

The factoring agreement can be terminated by CIT on 30-days written notice. The Company believes the factoring agreement with CIT, along with expected cash flow from operating activities and current levels of working capital are adequate to fulfill the Company's liquidity needs for the foreseeable future.

The Company may also issue letters of credit through CIT for the purchase of inventory in the normal course of its operations. At August 31, 2006, the Company had outstanding letters of credit opened through CIT of approximately \$6.1 million for the purchase of finished goods.

The Company did not declare or pay any cash dividends in fiscal years 2005 or 2006. The Company does not have a stated dividend policy. On a quarterly basis the board evaluates the ability to pay dividends based upon

profitability and financing needs.

### Contractual Obligations and Commercial Commitments

The following table illustrates the Company's contractual obligations and commercial commitments as of August 31, 2006:

|                                 | Payments due/Commitments expiring per period |                     |              |              |                 |
|---------------------------------|--|---------------------|--------------|--------------|-----------------|
|                                 | Total Amounts<br>Committed                   | Less than<br>1 year | 1 -3 years   | 4 -5 years   | Over<br>5 years |
| Operating leases                | \$ 6,543,000                                 | \$ 977,000          | \$ 1,352,000 | \$ 1,100,000 | \$ 3,114,000    |
| Letters of credit               | 6,086,000                                    | 6,086,000           |              |              |                 |
| Employment agreement            | 733,000                                      | 160,000             | 320,000      | 253,000      |                 |
| Notes payable                   | 513,000                                      | 513,000             |              |              |                 |
| Guarantees                      | 3,000,000                                    |                     |              | 3,000,000*   |                 |
| Total obligations & commitments | \$ 16,875,000                                | \$ 7,736,000        | \$ 1,672,000 | \$ 4,353,000 | \$ 3,114,000    |

\* Due on demand

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### Inventory

In its ordinary course of operations, the Company generally makes some sales below its normal selling prices or below cost. Based on experience, management believes this will be true for some inventory held on or acquired after August 31, 2006. The amount of such sales depends on several factors, including general economic conditions, market conditions within the apparel industry, the desirability of the styles held in inventory and competitive pressures from other garment suppliers.

The Company's inventory increased from \$4.6 million at August 31, 2005 to \$12.4 million at August 31, 2006. The Company has established an inventory markdown reserve as of August 31, 2006, which management believes will be sufficient for current inventory that is expected to be sold below cost in the future. There can be no assurance that the Company will realize its expected selling prices or that the inventory markdown reserve will be adequate for items in inventory as of August 31, 2006 for which customer sales orders have not yet been received. The inventory markdown reserve is calculated based on specific identification of aged goods and styles that are slow-moving or selling off-price.

### Impact of Exchange Rates

While the Company purchased over 98% of its products from foreign manufacturers in fiscal 2006, all of its purchases are denominated in United States dollars. Because the Company's products are sold primarily in the United States in dollar denominated transactions, the Company does not engage in currency hedging to reduce currency risk. A prolonged increase in the value of the dollar versus foreign currencies could enhance the Company's purchasing power for new purchase orders and reduce its cost of goods sold. Conversely, a prolonged decrease in the value of the dollar relative to foreign currencies could result in an increase in the Company's cost of manufacturing for new purchase orders and costs of goods sold.

### Impact of Inflation and Deflation

Management does not believe that inflation has had any material impact upon the Company's revenues or income from operations to date. Management believes that the apparel sector in which the Company operates continues to experience deflation, contrary to the modest inflation experienced in the economy in general. The persistence of the consumer to buy "on sale" merchandise has put pressure on retail gross margins, which in turn has led to downward pressure from retailers on wholesale gross margins, in the form of lower negotiated purchase prices as well as selling cost adjustments taken as deductions against invoices issued by the Company.

In the apparel industry, these selling cost adjustments are commonly referred to as markdown allowances or chargebacks. Without a corresponding decrease in fabric and labor prices, these markdown allowances have led to a decline in wholesale gross margins. The Company incurred \$975,000 in markdown allowances in fiscal 2006, as compared to \$652,000 incurred in fiscal 2004. Management believes these deflationary pressures will continue into the foreseeable future.

### **Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles 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 from those estimates.

### **Recently Issued Accounting Pronouncements**

In September 2006, the U.S. Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB 108 eliminates the diversity of practice regarding how public companies quantify financial statement misstatements. It establishes an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the company's financial statements and the related financial statement disclosures. SAB 108 must be applied to annual financial statements for fiscal years ending after November 15, 2006. The Company does not expect SAB 108 to have a material impact on its financial condition or results of operations.

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In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement (SFAS 157). This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We have not yet determined the impact that the implementation of SFAS 157 will have on our results of operations or financial condition.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No 109, (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides related guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. FIN 48 is effective for the Company's fiscal year ending August 31, 2008. Although the Company will continually evaluate its accounting policies, management does not currently believe that adoption will have a material impact on the Company's results of operations, cash flows, or financial position.

### **Item 7A - Quantitative and Qualitative Disclosures About Market Risk**

Market risk represents the potential impact to our financial position, results of operations or cash flows due to adverse changes in the financial markets. We are exposed to market risk from changes in the base interest rate of our variable rate debt. A 1% change in interest rates would increase or decrease our annual interest expense by approximately \$82,000.

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### **Item 8 - Financial Statements and Supplementary Data**

#### **Nitches, Inc. and Subsidiaries**



***Index to Consolidated Financial Statements Filed with  
the Annual Report of the Company on Form 10-K***

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| Consolidated Statements of Shareholders' Equity for the years ended August 31, 2006, 2005 and 2004 | <b>22</b>   |
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**Report of Independent Registered Public Accounting Firm**

Board of Directors and Shareholders  
Nitches, Inc. and Subsidiaries  
San Diego, California

We have audited the accompanying consolidated balance sheets of Nitches, Inc. and subsidiaries as of August 31, 2006 and 2005 and the related consolidated statements of operations, shareholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Nitches, Inc. and subsidiaries as of August 31, 2005 and 2006 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Berenson LLP

New York, New York  
November 15, 2006

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**Report of Independent Registered Public Accounting Firm**

Board of Directors and Shareholders  
Nitches, Inc.  
San Diego, California

We have audited the accompanying consolidated statements of income, shareholders' equity and cash flows of Nitches, Inc. and subsidiaries for the year ended August 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of Nitches, Inc. and subsidiaries for the year ended August 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Los Angeles, California  
October 22, 2004

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### NITCHES, INC. AND SUBSIDIARIES Consolidated Balance Sheets

|                                       | ASSETS        |               |
|---------------------------------------|---------------|---------------|
|                                       | August 31,    |               |
|                                       | 2006          | 2005          |
| <b>Current assets:</b>                |               |               |
| Cash and cash equivalents             | \$ 228,000    | \$ 192,000    |
| <b>Receivables:</b>                   |               |               |
| Due from factor, net                  | 10,057,000    | 3,749,000     |
| Trade accounts, net                   | 484,000       | 473,000       |
| Due from affiliates and employees     | 18,000        | 11,000        |
| Total receivables                     | 10,559,000    | 4,233,000     |
| Refundable income taxes               | -             | 212,000       |
| Inventories, less allowances          | 12,424,000    | 4,582,000     |
| Deferred income taxes, current        | 587,000       | 867,000       |
| Other current assets                  | 628,000       | 302,000       |
| Total current assets                  | 24,426,000    | 10,388,000    |
| Property and equipment, net           | 164,000       | 38,000        |
| Goodwill                              | 2,620,000     |               |
| Intangibles, net                      | 3,543,000     |               |
| Deferred income taxes, net of current | -             | 10,000        |
| Other assets                          | 31,000        | 17,000        |
| Total assets                          | \$ 30,784,000 | \$ 10,453,000 |

### LIABILITIES AND SHAREHOLDERS' EQUITY

|                             |              |              |
|-----------------------------|--------------|--------------|
| <b>Current liabilities:</b> |              |              |
| Due to factor               | \$ 9,676,000 | \$ 3,131,000 |

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|   |               |               |
|---|---------------|---------------|
| Accounts payable  | 9,349,000     | 2,276,000     |
| Accrued expenses  | 1,163,000     | 640,000       |
| Notes Payable   | 513,000       |               |
| Income taxes payable  | 89,000        | -             |
| Total current liabilities   | 20,790,000    | 6,047,000     |
| <b>Long term liabilities:</b>   |               |               |
| Loss on equity investment   | -             | 146,000       |
| Deferred income taxes long term   | 736,000       |               |
| Total long term liabilities   | 736,000       | 146,000       |
| <b>Commitments and contingencies:</b>   |               |               |
| <b>Shareholders' equity:</b>  |               |               |
| Series A preferred stock, \$100 par value;<br>25,000,000 shares authorized,<br>8,820 shares issued and outstanding                              | 882,000       | -             |
| Common stock, no par value; 50,000,000 shares<br>authorized;<br>4,653,507 shares in 2006 and 3,513,507<br>shares in 2005 issued and outstanding | 5,143,000     | 1,495,000     |
| Retained earnings   | 3,233,000     | 2,765,000     |
| Total shareholders' equity  | 9,258,000     | 4,260,000     |
| Total liabilities and shareholders' equity  | \$ 30,430,000 | \$ 10,453,000 |

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

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**NITCHES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Operations**

|  | Fiscal Year Ended August 31, |                |               |
|--|------------------------------|----------------|---------------|
|  | 2006                         | 2005           | 2004          |
| Net sales                                    | \$ 54,832,000                | \$ 26,320,000  | \$ 32,179,000 |
| Cost of goods sold                           | 39,985,000                   | 20,534,000     | 22,783,000    |
| Gross profit                                 | 14,847,000                   | 5,786,000      | 9,396,000     |
| Selling, general and<br>administrative       | 13,763,000                   | 8,175,000      | 8,389,000     |
| Income (loss) from<br>operations             | 1,084,000                    | (2,389,000)    | 1,007,000     |
| Other income                                 | 2,000                        | 460,000        | -             |
| Interest expense                             | (486,000)                    | (102,000)      | (93,000)      |
| Income (loss) from equity<br>investment      | (11,000)                     | (64,000)       | 14,000        |
| Income (loss) before<br>income taxes         | 589,000                      | (2,095,000)    | 928,000       |
| Provision for (benefit from)<br>income taxes | 121,000                      | (894,000)      | 371,000       |
| Net income (loss)                            | \$ 468,000                   | \$ (1,201,000) | \$ 557,000    |
| Basic earnings (loss) per<br>share           | \$0.11                       | (\$0.34)       | \$0.16        |

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|   |           |           |           |
|---|-----------|-----------|-----------|
| Diluted earnings per share                      | \$0.11    | (\$0.34)  | \$0.16    |
| Weighted average number of common shares        |           |           |           |
| Basic   | 4,077,014 | 3,513,507 | 3,513,507 |
| Diluted   | 4,077,014 | 3,513,507 | 3,513,507 |
| Number of common shares outstanding at year end | 4,653,507 | 3,513,507 | 3,513,507 |

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

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**NITCHES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Shareholders' Equity**

|                                 | Preferred Stock |            | Common Stock |              | Retained Earnings | Total Shareholders' Equity |
|---------------------------------|-----------------|------------|--------------|--------------|-------------------|----------------------------|
|                                 | Shares          | Amount     | Shares       | Amount       |                   |                            |
| <b>Balance, August 31, 2003</b> | -               | \$ -       | 3,513,507    | \$ 1,495,000 | \$ 3,409,000      | \$ 4,904,000               |
| Net income                      |                 |            |              |              | 557,000           | 557,000                    |
| <b>Balance, August 31, 2004</b> | -               | -          | 3,513,507    | 1,495,000    | 3,966,000         | 5,461,000                  |
| Net loss                        |                 |            |              |              | (1,201,000)       | (1,201,000)                |
| <b>Balance, August 31, 2005</b> | -               | -          | 3,513,507    | 1,495,000    | 2,765,000         | 4,260,000                  |
| Shares issued in transactions   | 8,820           | 882,000    | 1,140,000    | 3,648,000    | -                 | 4,530,000                  |
| Net income                      |                 |            |              |              | 468,000           | 468,000                    |
| <b>Balance, August 31, 2006</b> | 8,820           | \$ 882,000 | 4,653,507    | \$ 5,143,000 | \$ 3,233,000      | \$ 9,258,000               |

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

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**NITCHES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**

|  | Year ended August 31, |                |             |
|--|-----------------------|----------------|-------------|
|  | 2006                  | 2005           | 2004        |
| Cash flows from operating activities:  |                       |                |             |
| Net income(loss)   | \$ 468,000            | \$ (1,201,000) | \$ 557,000  |
| Adjustment to reconcile net income(loss) to net cash used by operating activities: |                       |                |             |
| Depreciation and amortization  | 358,000               | 27,000         | 26,000      |
| (Income)loss from investment in unconsolidated subsidiary                          | 11,000                | 64,000         | (14,000)    |
| (Increase)decrease in due from factor  | (2,922,000)           | 1,013,000      | (2,598,000) |
| (Increase)decrease in trade receivables  | (18,000)              | 280,000        | (464,000)   |
| (Increase) decrease in refundable income taxes                                     | 212,000               | (266,000)      | 520,000     |

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|   |                    |                    |                   |
|---|--------------------|--------------------|-------------------|
| Increase in deferred income taxes                         | (7,000)            | (577,000)          | (55,000)          |
| (Increase) decrease in inventories                        | (2,618,000)        | (1,209,000)        | 1,601,000         |
| Increase in other assets                                  | (232,000)          | (213,000)          | (32,000)          |
| (Increase) decrease in other current assets               |                    |                    |                   |
| Increase in accounts payable and accrued expenses         | 1,225,000          | 1,031,000          | 178,000           |
| (Decrease) in income taxes payable                        | (126,000)          | -                  | -                 |
| <b>Net cash used by operating activities</b>              | <b>(3,649,000)</b> | <b>(1,051,000)</b> | <b>(281,000)</b>  |
| <b>Cash flows from investing activities:</b>              |                    |                    |                   |
| Acquisition cost of transactions                          | (103,000)          | -                  | -                 |
| Capital expenditures                                      | (44,000)           | (28,000)           | (7,000)           |
| Capital contribution in equity investment                 | -                  | (140,000)          | -                 |
| Cash acquired in transactions                             | 127,000            | -                  | -                 |
| <b>Net cash used by investing activities</b>              | <b>(20,000)</b>    | <b>(168,000)</b>   | <b>(7,000)</b>    |
| <b>Cash flows from financing activities:</b>              |                    |                    |                   |
| Notes Payable   | 513,000            | -                  | -                 |
| Advances from factor                                      | 3,192,000          | 1,192,000          | 397,000           |
| <b>Net cash provided by financing activities</b>          | <b>3,705,000</b>   | <b>1,192,000</b>   | <b>397,000</b>    |
| <b>Net increase (decrease) in cash</b>                    | <b>36,000</b>      | <b>(27,000)</b>    | <b>109,000</b>    |
| Cash at beginning of year                                 | 192,000            | 219,000            | 110,000           |
| <b>Cash at end of year</b>                                | <b>\$ 228,000</b>  | <b>\$ 192,000</b>  | <b>\$ 219,000</b> |
| <b>Supplemental disclosures of cash flow information:</b> |                    |                    |                   |
| <b>Cash paid during the year:</b>                         |                    |                    |                   |
| Interest  | \$ 360,000         | \$ 102,000         | \$ 93,000         |
| Income taxes  | \$ 180,000         | \$ 118,000         | \$ 349,000        |
| <b>Non-cash investing activity:</b>                       |                    |                    |                   |
| Acquisition of remaining outstanding shares of subsidiary |                    |                    |                   |
| Common stock issued                                       | \$ 918,000         | \$ -               | \$ -              |
| Accrued earnings of unconsolidated subsidiary             | -                  | (8,000)            | (8,000)           |
| Series A preferred stock issued                           | 882,000            | -                  | -                 |
| Acquisition of Home Décor assets of Taresha               |                    |                    |                   |
| Common stock issued                                       | 2,730,000          | -                  | -                 |
|   | \$ 4,530,000       | \$ (8,000)         | \$ (8,000)        |

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

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**1. Description of Business**

Nitches, Inc. and subsidiaries (the "Company") engage in the wholesale importation and distribution of clothing and housewares manufactured to its specifications and distributed in the United States under Company brand labels and retailer-owned private labels. The Company's product lines are women's sleepwear, sportswear, western wear and outerwear, men's casual wear and golf apparel, men's and women's performance apparel and home décor items including candles and bath accessories.

**2. Summary of Significant Accounting Policies***Principles of Consolidation:*

The consolidated financial statements include the accounts of Nitches, Inc., its wholly-owned subsidiaries Nitches Far East Limited and Designer Intimates, Inc., and Designer Intimates' wholly-owned subsidiary NAP, Inc. All significant inter-company transactions and balances are eliminated in consolidation.

*Financial Instruments:*

Financial instruments consist of cash and cash equivalents, accounts receivable, and accounts payable. The carrying amount approximates fair value because of their short maturity.

*Concentration of Credit Risk:*

The Company sells a majority of its accounts receivable to a financial institution. Under the agreement, the financial institution purchases trade accounts receivable and assumes substantially all credit risks. This agreement is detailed in Note 5. The Company is responsible for following up on adjustments claimed by customers. Accounts that are not sold remain the credit risk of the Company. Such accounts are diverse and are subject to credit approval and ongoing evaluation by the Company. Management considers the credit risk with respect to all receivables to be low. Historically, the Company has not experienced significant loss due to uncollectible accounts receivable.

Cash balances are periodically maintained in amounts in excess of FDIC insured limits in high quality financial institutions. Management considers the risk of loss to be low.

*Inventories:*

Inventories are stated at the lower of cost (first-in, first-out method) or market.

*Furniture, Fixtures and Equipment:*

Furniture, fixtures and equipment are stated at cost. Depreciation is computed using the straight-line method based on the estimated useful lives of the related assets, which range from two to ten years. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful lives of the assets or the remaining term of the related lease. Maintenance and repair costs are charged to expense as incurred. When assets are retired or sold, the assets and accumulated depreciation are removed from the respective accounts and any profit or loss on the disposition is credited or charged to income.

*Earnings Per Share:*

The computation of net income per common share is based on the weighted average number of common shares outstanding plus common share equivalents arising from dilutive stock options, if any. At August 31, 2006, there were no stock options or similar instruments outstanding and therefore no dilutive effect to the number of shares outstanding. The earnings per share computations have been adjusted retroactively for all periods presented to reflect a 200% stock dividend issued on January 20, 2006. The weighted average number of common

shares and common share equivalents outstanding for basic and diluted earnings per share was 4,077,014 for fiscal 2006, and 3,513,507 for both fiscal 2005 and 2004.

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*Revenue Recognition:*

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

*Income Taxes:*

The Company records income taxes using an asset and liability method. Under this method, deferred Federal and state income tax assets and liabilities are provided for temporary differences between the financial reporting basis and the tax-reporting basis of the consolidated assets and liabilities. Income taxes are further explained in Note 9.

*Estimates:*

The preparation of financial statements in conformity with generally accepted accounting principles 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 from those estimates.

*Freight Costs:*

Freight charges billed to customers for the handling and delivery of products to their locations are included in net sales. Freight costs incurred from third party delivery services are included in cost of goods sold. Freight costs of \$210,000, \$268,000 and \$367,000 for the years ended August 31, 2006, 2005 and 2004, respectively, are included in cost of goods sold.

*Reclassification:*

The due to and from factor captions on the 2004 consolidated statement of cash flows have been reclassified to conform to the 2005 and 2006 financial statement presentation.

*Recently issued accounting pronouncements:*

In September 2006, the U.S. Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 108 (SAB 108), *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 eliminates the diversity of practice regarding how public companies quantify financial statement misstatements. It establishes an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the company's financial statements and the related financial statement disclosures. SAB 108 must be applied to annual financial statements for fiscal years ending after November 15, 2006. The Company does not expect SAB 108 to have a material impact on its financial condition or results of operations.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurement (SFAS 157)*. This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We have not yet determined the impact that the implementation of SFAS 157 will have on our results of

operations or financial condition.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No 109, (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position

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taken or expected to be taken in a tax return. This Interpretation also provides related guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. FIN 48 is effective for the Company's fiscal year ending August 31, 2008. Although the Company will continually evaluate its accounting policies, management does not currently believe that adoption will have a material impact on the Company's results of operations, cash flows, or financial position.

### 3. Acquisitions

#### Designer Intimates

On October 24, 2005, Nitches acquired from Haresh Tharani, Victor Lee, Manu Mirchandani, Eitan Haber, and Mahesh Tharani the ("Sellers") the remaining balance of seventy-two percent (72%) of the issued and outstanding stock of Designer Intimates, Inc., a Delaware corporation (Designer Intimates) which the Company did not own, resulting in Nitches owning one hundred percent (100%) of Designer Intimates. The aggregate purchase price for the acquisition was \$1,800,000. Nitches issued to the Sellers 180,000 restricted shares of its common stock at a value of \$5.10 per share and \$882,000 of preferred stock. The following is a condensed balance sheet showing the fair values of the assets acquired and liabilities assumed as of the date of acquisition:

|                                     |              |
|-------------------------------------|--------------|
| Accounts receivable                 | \$ 3,386,000 |
| Inventory                           | 3,569,000    |
| Intangibles                         | 2,618,000    |
| Other assets                        | 725,000      |
| Goodwill arising in the transaction | 2,620,000    |
| Total assets acquired               | 12,918,000   |
| Current liabilities                 | 7,765,000    |
| Loan payable, factor                | 3,353,000    |
| Total liabilities assumed           | 11,118,000   |
| Net assets acquired                 | \$ 1,800,000 |

Designer Intimates is a New York City based importer and distributor of women's sleepwear, robes, loungewear, swimwear and intimate apparel; men's sleepwear, robes, and loungewear; and infant's and children's sleepwear and robes. Designer Intimates owns the brand Anne Lewin, and also sells product under the Princess tam tam, Derek Rose, Crabtree & Evelyn, Gossard, Dockers, and Vasserette brands through licensing or distribution agreements. These products are sold to better department stores, boutiques, moderate department stores, and national and regional discount department stores and chains. Designer Intimates further has private label sales to Disney, Victoria's Secret, and other select specialty stores. The assets of Designer Intimates include finished goods inventory, customer lists, customer orders, trade names, brand licenses, brand distribution agreements, office leases in New York City and Atlanta, and office equipment, furniture and fixtures, all of which Nitches continues to use.

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



|  | <b>Year Ended August 31,</b> |               |
|--|------------------------------|---------------|
|  | <b>2006</b>                  | <b>2005</b>   |
| Net sales                                    | \$ 60,176,000                | \$ 66,361,000 |
| Net income (loss)                            | 327,000                      | (1,256,000)   |
| Net income (loss) per weighted average share | \$ 0.08                      | \$ (0.31)     |
| Weighted average shares outstanding          | 4,053,507                    | 4,053,507     |

In October 2002, the Company acquired a 28% interest in Designer Intimates, which owns 100% of NAP, Inc., a New York-based intimate apparel company. Designer Intimates had acquired NAP from its founders and obtained a credit line of approximately \$12 million from HSBC which was later assumed by CIT, secured by the inventory and accounts receivable of NAP and the guarantees of shareholders of Designer Intimates. Nitches guaranteed \$3 million of this credit line and this guaranty formed the consideration from Nitches for its 28% ownership interest in Designer Intimates. Through October 23, 2005 the Company reported any income or loss from the ongoing operation of

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Designer Intimates using the equity method of accounting, whereby Nitches' 28% interest in Designer Intimates was reported as a single line item on the Consolidated Statement of Income.

#### **Home Décor**

On June 24, 2006, Nitches entered into an Asset Purchase Agreement with Taresha LLC, a New Jersey limited liability corporation ("Taresha"), to acquire from Taresha substantially all of the assets of its Home Décor business as of July 1, 2006. The purchase price for the assets was \$2,730,000. Nitches issued to Taresha 600,000 shares of its common stock valued at \$4.55 per share (based on the average closing price for the common stock for the ten trading days between June 7 and June 20, 2006, inclusive). The allocation of the Home Décor purchase price was as follows:

|                    |              |
|--------------------|--------------|
| Inventory          | \$ 1,655,000 |
| Bill Blass license | 1,075,000    |
|                    | \$ 2,730,000 |

The Home Décor business involves the design, sale, and distribution of made-to-order candles, candle holders and other home decorating accessories. These products are sold under the Bill Blass, Michael Coffindaffer and Newport Blue brands primarily to the same retailers as Nitches' apparel products. Assets acquired included inventory, order backlog, customer lists, licenses and license agreements. As part of the transaction Nitches will retain all key executives in product development, sales and production.

Mr. Haresh Tharani is the controlling equity owner of Taresha. Mr. Tharani is a shareholder of Nitches, Inc. and was the controlling shareholder of Designer Intimates, Inc., which Nitches acquired on October 24, 2005. After the issuance of the 600,000 shares in connection with the Agreement, Mr. Tharani beneficially owns approximately 18.5% of the outstanding common stock of Nitches. There are no agreements or arrangements in place to appoint Mr. Tharani or any representatives of Taresha to serve on the board of directors or as an executive officer of Nitches. The 600,000 shares issued pursuant to the Agreement are subject to a lock-up agreement between Nitches and Taresha that restricts these shares from trading, voting or receiving any benefit such as dividends unless and until the remaining Nitches shareholders approve the Agreement and the stock issuance.

#### **4. Inventories**

**August 31,**  
**2006                      2005**

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|                     |               |              |
|---------------------|---------------|--------------|
| Fabric and trim     | \$ 222,000    | \$ 254,000   |
| In-Transit          | 2,939,000     | 1,530,000    |
| Finished goods      | 9,651,000     | 2,883,000    |
| Markdown allowances | (388,000)     | (85,000)     |
|                     | \$ 12,424,000 | \$ 4,582,000 |

**5. Furniture, Fixtures and Equipment**

|  | August 31, |           |
|--|------------|-----------|
|  | 2006       | 2005      |
| Leasehold improvements                         | \$ 610,000 | \$ 20,000 |
| Computer equipment                             | 284,000    | 33,000    |
| Vehicles                                       | 111,000    | 111,000   |
| Furniture, fixtures and other equipment        | 185,000    | 38,000    |
|  | 1,190,000  | 202,000   |
| Less accumulated depreciation and amortization | 1,026,000  | 164,000   |
|  | \$ 164,000 | \$ 38,000 |

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**6. Accounts Receivable**

Pursuant to the terms of an agreement between Nitches and a factor, Nitches sells a majority of its trade accounts receivable to the factor on a pre-approved, non-recourse basis. The price at which the accounts are sold is the invoice amount reduced by the factor commission (.3% of the invoice amount) and all selling discounts. For accounts sold to the factor without recourse, the factor is responsible for collection, assumes all credit risk, and obtains all of the rights and remedies against the company's customers. For such accounts, payment is due from the factor upon the earlier of the payment of the receivable to the factor by the customer, or the maturity of the receivable (generally 180 days from the date of shipment to the customer). As of August 31, 2006, non-recourse receivables totaled \$10.5 million.

Trade accounts receivable not sold to the factor remain in the custody and control of the Company and the Company maintains all credit risk on those accounts as well as accounts which are sold to the factor with recourse. The combined credit risk for non-factored and recourse receivables as of August 31, 2006, totaled \$712,000.

The Company may request payment from the factor in advance of the collection date or maturity. Any such advance payments are assessed an interest charge through the collection date or maturity at the factor's prime rate less 1.5% (one and one half percent) per annum. The company's obligations with respect to advances from the factor are limited to the interest charges thereon. Advance payments are limited to a maximum of 85% (eighty-five percent) of eligible accounts receivable. The factoring agreement also provides for the issuance of irrevocable letters of credit for the Company's purchase of inventory in the normal course of its business. All assets of the company collateralize the advances and letters of credit. The Company's Chairman has also provided a personal guaranty in connection with the factoring arrangement. The factoring agreement can be terminated by CIT on 30-days written notice.

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

|                                 | August 31, |      |
|---------------------------------|------------|------|
|                                 | 2006       | 2005 |
| Receivables assigned to factor: |            |      |

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|  |              |            |
|--|--------------|------------|
| Non-recourse   | 10,472,000   | 3,827,000  |
| Recourse   | 168,000      | 110,000    |
| Allowance for customer credits and doubtful accounts     | (583,000)    | (188,000)  |
| Due from factor, net                                     | 10,057,000   | 3,749,000  |
| Non-factored accounts receivable                         | \$ 544,000   | \$ 557,000 |
| Allowance for customer credits and doubtful accounts     | (60,000)     | (84,000)   |
| Trade receivables, less allowances                       | \$ 484,000   | \$ 473,000 |
| Due to factor  | \$ 9,676,000 | 3,131,000  |
| Contingent liabilities for irrevocable letters of credit | \$ 6,086,000 | 3,520,000  |

**7. Note Payable:**

At August 31, 2006 the Company had a note payable to an officer for \$513,000. This note was advanced for the purchase of inventory. The note is due upon demand and accrues interest at the same rate as the Company's borrowing rate with CIT, which is currently 6.75%.

**8. Intangible Assets:**

As part of the purchase of Designer Intimates Inc., the Company acquired intangible assets of \$2.6 million. Of that amount \$902,000 was assigned to trademarks that are permanent in nature, \$892,000 was assigned to customer lists and vendor agreements, \$721,000 was assigned to the Crabtree and Evelyn license and \$103,000 was assigned to costs capitalized as part of the acquisition. Goodwill of \$2.6 million, which is not subject to amortization, arose in connection with the acquisition. The Company also acquired an additional \$1.1 million in intangible assets related to the Bill Blass Home Décor license purchased from Taresha, LLC in July 2006.

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Following is a summary of non-goodwill intangibles at the end of the current year:

|   | <b>August 31, 2006</b>  |                                     |
|---|-------------------------|-------------------------------------|
|   | <b>Gross<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> |
| Intangibles subject to amortization     | \$ 2,791,000            | \$ 150,000                          |
| Intangibles not subject to amortization | \$ 902,000              | -                                   |

Amortization expense for fiscal year 2006 was \$150,000. The estimated amortization expense for each of the ensuing years through August 31, 2011 is \$234,000, \$234,000, \$234,000, \$234,000 and \$134,000 respectively. In accordance with SFAS 142 intangible assets that are subject to amortization are reviewed for potential impairment whenever events or circumstances indicate that carrying amounts may not be recoverable. Assets not subject to amortization are tested for impairment at least annually.

**9. Income Taxes**

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The components of the provision/(benefit) for income taxes are as follows:

|                            | <b>Year ended August 31,</b> |                      |                   |
|----------------------------|------------------------------|----------------------|-------------------|
|                            | <b>2006</b>                  | <b>2005</b>          | <b>2004</b>       |
| <b>Current:</b>            |                              |                      |                   |
| Federal                    | \$ (21,000)                  | \$ (320,000 )        | \$ 346,000        |
| State                      | 149,000                      | 3,000                | 80,000            |
|                            | 128,000                      | (317,000 )           | 426,000           |
| <b>Deferred</b>            |                              |                      |                   |
| Federal                    | 184,000                      |                      |                   |
| State                      | (191,000)                    |                      |                   |
|                            | (7,000)                      | (577,000)            | (55,000)          |
| <b>Provision/(Benefit)</b> | <b>\$ 121,000</b>            | <b>\$ (894,000 )</b> | <b>\$ 371,000</b> |

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Net deferred income tax assets at August 31, 2006 and 2005 consist of the tax effects of temporary differences related to the following:

|   | <b>August 31,</b> |                   |
|---|-------------------|-------------------|
|   | <b>2006</b>       | <b>2005</b>       |
| <b>Current deferred assets:</b>             |                   |                   |
| Inventories                                 | \$ 274,000        | \$ 160,000        |
| Sales returns and doubtful account reserves | 237,000           | 106,000           |
| Net operating loss                          | -                 | 573,000           |
| State tax                                   | 39,000            | -                 |
| Accrued compensation                        | 19,000            | 28,000            |
| Tax credits                                 | 12,000            | -                 |
| Other items                                 | 6,000             | -                 |
|   | <b>\$ 587,000</b> | <b>\$ 867,000</b> |

|                                     | <b>August 31,</b>   |                  |
|-------------------------------------|---------------------|------------------|
|                                     | <b>2006</b>         | <b>2005</b>      |
| <b>Non-current deferred assets:</b> |                     |                  |
| Accumulated depreciation            | \$ 163,000          | \$ 10,000        |
| Intangibles                         | \$ (955,000)        | -                |
| Net operating loss                  | 56,000              | -                |
|                                     | <b>\$ (736,000)</b> | <b>\$ 10,000</b> |

In assessing the realizability of deferred tax assets of \$806,000 at August 31, 2006, management considered whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

Differences between the statutory Federal income tax rate and the effective tax rate as a percentage of pre-tax income are as follows:

|  | <b>Year ended August 31,</b> |             |             |
|--|------------------------------|-------------|-------------|
|  | <b>2006</b>                  | <b>2005</b> | <b>2004</b> |

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|  |         |         |        |
|--|---------|---------|--------|
| Statutory rate                             | 34.0%   | (34.0%) | 34.0%  |
| State income taxes, net of federal benefit | 5.8%    | (5.8%)  | 5.8%   |
| (Income)/loss on equity investment         | 0.7%    | (2.8%)  | (0.5%) |
| Nondeductible expenses                     | 2.5%    | 0.0%    | 0.2%   |
| Other items                                | (22.7%) | (0.1%)  | 0.5%   |
| Effective rate                             | 20.3%   | (42.7%) | 40.0%  |

The amount and expiration dates of net operating loss carry forwards are as follows:

|                                     |         |
|-------------------------------------|---------|
| <b>Expiring August<br/>31, 2015</b> |         |
| Federal                             | \$ -    |
| State                               | 965,000 |

### 10. Employee Benefit Plans

The Company has a 401(k) Savings Plan, whereby employees may make investments in various independently managed funds and Company stock. The Company may match employee contributions to this Plan on a discretionary basis or contribute on a profit sharing basis. The Company made no matching or profit sharing contributions to this Plan in fiscal 2006, 2005, or 2004.

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### 11. Stock Options and Dividends

#### Stock Options

No stock options were outstanding as of August 31, 2006, 2005 or 2004. At the Company's annual meeting on March 15, 2006, shareholders approved the Nitches 2006 Equity Incentive Plan authorizing the issuance of up to 600,000 shares of stock in the form of incentive stock options, nonstatutory stock options, stock grants and restricted stock. However, no stock options, stock grants or restricted stock were issued under the plan as of August 31, 2006.

#### Dividends

The Company did not pay any cash dividends during 2004, 2005 or 2006. On January 20, 2006 the Company issued a 200% stock dividend to shareholders of record as of January 3, 2006. This stock dividend had the effect of tripling the outstanding number of shares of the Company.

### 12. Leases

The Company has lease commitments expiring at various dates through February 2017, principally for real property and equipment. The aggregate minimum rental commitments for the ensuing five years ending August 31 for all non-cancelable leases having initial or remaining terms of one or more years are as follows:

|                              |           |
|------------------------------|-----------|
| <b>2007</b>                  | \$977,000 |
| <b>2008</b>                  | 802,000   |
| <b>2009</b>                  | 550,000   |
| <b>2010</b>                  | 550,000   |
| <b>2011</b>                  | 550,000   |
| <b>2012 &amp; thereafter</b> | 3,025,000 |

|                     |             |
|---------------------|-------------|
| <b>Total leases</b> | \$6,454,000 |
|---------------------|-------------|

The Company's leases for real property are generally subject to rent escalation based on increases in the consumer price or other indices with certain minimum and maximum increases. Rent expense, net of sublease income, was approximately \$1.0 million, \$406,000, and \$391,000, during fiscal 2006, 2005 and 2004, respectively.

### **13. Employment Agreement**

The Company has an employment agreement with Paul M. Wyandt effective April 1, 2006 through March 31, 2011. Pursuant to this agreement, Mr. Wyandt serves as President and Chief Operating Officer of the Company. The agreement provides for a base annual salary of \$160,000, or a higher amount as the Board of Directors may approve. In addition, Mr. Wyandt may receive a bonus at the discretion of the Board of Directors. The minimum annual commitments of the Company under this agreement are summarized below:

|                         |           |
|-------------------------|-----------|
| <b>2007</b>             | \$160,000 |
| <b>2008</b>             | 160,000   |
| <b>2009</b>             | 160,000   |
| <b>2010</b>             | 160,000   |
| <b>2011</b>             | 93,333    |
| <b>Total commitment</b> | \$733,333 |

Salary paid to Mr. Wyandt was \$160,000 in fiscal 2006, 2005, and 2004. No bonuses were paid in these years.

### **14. Operating Segments and Major Customers**

The Company's products comprise a single operating segment. No significant assets are maintained outside the United States. Sales are made to a variety of customers throughout the United States. Sales to three customers accounted for 21.6%, 10.9% and 11.2% of the Company's net sales during fiscal 2006. Sales to one customer accounted for 53.1% of the Company's net sales in fiscal 2005.

Two major customers accounted for 39.7% and 11.5%, respectively, of the Company's trade receivable balance at August 31, 2006. Two different major customers accounted for 32.7% and 14.1%, respectively, of the Company's trade receivable balance at August 31, 2005.

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### **15. Quarterly Results of Operations (Unaudited)**

The following is a summary of the quarterly results of operations for the years ended August 31, 2006 and 2005.

|                                | <b>Three months ended</b> |                    |               |                  |
|--------------------------------|---------------------------|--------------------|---------------|------------------|
|                                | <b>November 30</b>        | <b>February 28</b> | <b>May 31</b> | <b>August 31</b> |
| <b>Fiscal 2006</b>             |                           |                    |               |                  |
| Net sales                      | \$14,715,000              | \$12,314,000       | \$12,580,000  | \$15,223,000     |
| Gross profit                   | 4,333,000                 | 3,559,000          | 3,700,000     | 3,255,000        |
| Net income (loss)              | 520,000                   | 45,000             | 33,000        | (130,000)        |
| Net income (loss) per weighted | \$0.14                    | \$0.01             | \$0.01        | (\$0.03)         |
| <b>Fiscal 2005</b>             |                           |                    |               |                  |
| Net sales                      | \$6,337,000               | \$6,521,000        | \$7,403,000   | \$6,059,000      |
| Gross profit                   | 1,648,000                 | 1,263,000          | 1,595,000     | 1,280,000        |
| Net income (loss)              | (12,000)                  | (524,000)          | (188,000)     | (477,000)        |

|                                    |        |          |          |          |
|------------------------------------|--------|----------|----------|----------|
| Net income (loss) per common share | \$0.00 | (\$0.15) | (\$0.05) | (\$0.14) |
|------------------------------------|--------|----------|----------|----------|

### 16. Subsequent Event

On October 24, 2006, Nitches completed its acquisition of the Saguaro® mark and related trademarks from Impex Inc., a leading manufacturer of branded and non-branded specialty, western and private-label women's apparel. Nitches paid consideration of \$3,030,000 to Impex in the form of 600,000 shares of Nitches common stock valued at \$4.55 per share (based on the average closing price for the common stock for the ten trading days between June 7 and June 20, 2006, inclusive) and a \$300,000 promissory note. Since January 2005, the Company had been manufacturing and distributing Saguaro® apparel products to specialty and catalog retailers under the terms of a strategic alliance with Impex. Under this alliance, Nitches recorded the revenue from such sales and remitted royalties and design fees to Impex as part of its operating expenses. Due to the closing of the Acquisition Agreement, Nitches is not required to pay such fees to Impex as of January 1, 2006. Accordingly, profit margins for Saguaro® products are expected to increase. Royalty and design fees accrued and paid from September through December 2005 were approximately \$183,000.

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### Item 9 - Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

### Item 9A - Controls and Procedures

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

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

As required by Securities and Exchange Commission Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive and financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of August 31, 2006, the end of the period covered by this report. Based on that evaluation, our chief executive and financial officer concluded that certain control deficiencies, as described below existed in our internal control over financial reporting as of August 31, 2006. As a result of these deficiencies our chief executive and financial officer concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of August 31, 2006.

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

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

*Our accounting staff did not have significant recent experience in the closing procedures and the disclosure issues related to our recent acquisitions.* During the year ended August 31, 2006 we completed the acquisition of Designer Intimates and the Home Décor business of Taresha, LLC. Those were the first acquisition transactions that we had completed in some time. In connection with those acquisitions, we were required to conduct additional financial procedures, including valuation analysis and goodwill impairment testing. Those additional procedures and the unique accounting issues raised by those transactions, impacted our ability to timely process and report information.

*At August 31, 2006 we had not integrated the Home Décor product line into our accounting systems.* In connection with the acquisition of the Home Décor business from Taresha LLC we were compelled to integrate their financial results of operations. However, we did not acquire Taresha's accounting systems or any additional accounting personnel in connection with that acquisition. As a result we were compelled to coordinate with Taresha LLC and its financial consultants to procure the appropriate information. While we did secure the information, our lack of control over the processes and delays in coordination impacted our ability to timely process and report information.

*Responsibility for closing procedures was too highly concentrated on our executive officers.* We closed our acquisition of the Saguaro brand from Impex, Inc. after the year ended August 31, 2006, and were required to disclose the terms of the transaction as a subsequent event. Our executive officers that are responsible for conducting the majority of the closing procedures in connection with the preparation of our financial reports were engaged in negotiating an amendment to and subsequently the closing of the Impex, Inc. transaction. The time commitment required to complete that transaction impacted their ability to timely complete their closing procedures for this Annual Report on Form 10-K.

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

- We increased our use of experienced outside consultants to perform certain processes, including valuation analysis, goodwill impairment and tax related issues.
- We procured training and education for some of our accounting managers in accounting issues that became relevant as a result of recent changes in our business including our recent acquisitions.
- We began the integration of the Home Décor product line into our internal accounting systems.
- We reallocated a portion of our closing procedures away from our executive officers and to accounting managers to reduce our dependence on scarce management resources to complete closing procedures.

The deficiency related to our staffing was not remedied as of August 31, 2006. We are continuing to reorganize our accounting functions and processes. We expect that this remediation may take an additional quarter to complete.

*(b) Changes In Internal Controls Over Financial Reporting.* During the fiscal quarter ending August 31, 2006, we completed the acquisition of the Home Décor business of Taresha LLC. In connection with that acquisition, we integrated accounting systems and financial personnel associated with that business into our operations. With the exception of the Home Décor acquisition, no changes were made in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during our most recent fiscal quarter that has materially affected, or is likely to materially affect, our internal control over financial reporting.

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### PART III

#### Item 10 - Directors and Executive Officers of the Registrant



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The following table sets forth certain information with respect to the Directors and executive officers of the Company:

| NAME                | AGE | POSITION  |
|---------------------|-----|---|
| Steven P. Wyandt    | 61  | Chairman, Chief Executive Officer and Chief Financial Officer |
| Paul M. Wyandt      | 38  | Director, President and Chief Operating Officer               |
| Eugene B. Price II  | 63  | Director (Independent)  |
| Michael D. Sholtis  | 58  | Director (Independent)  |
| T. Jefferson Straub | 64  | Director (Independent)  |

Mr. Steven Wyandt has been a director since 1989. He has been CEO of the Company since 1987. Mr. Wyandt was a director and Chairman of Body Drama, Inc. until August 31, 1998, which at the time was a wholly owned subsidiary of the Company but was merged into the Company as of that date. Steven Wyandt is the father of Paul Wyandt, an officer and director of the Company.

Mr. Paul Wyandt has been a director since 2001. He has been President and COO since 2001. He has been with the Company in the areas of finance, accounting, marketing and technology since 1997. Prior to that, he was Vice President of Finance and Operations of CMS Technologies, a company that designed hardware and software for personal computer security.

Mr. Price has been a director since 1973. From 1973 until he retired in May 1987, Mr. Price was a Vice President of the Company with primary responsibilities in sales and administration.

Mr. Sholtis is a seasoned retail executive with over 30 years of management experience with regional and national retailers including Belk Stores, McCraes, Sears, May Company and Allied Stores. He is a current member of the Retail, Textile and Marketing Board of the University of North Carolina, Greensboro.

Mr. Straub has served since 1975 as the president of Profit Management Consultants, a firm specializing in strategic planning, capital finance, and mergers & acquisitions. He also teaches courses in finance and international business as an adjunct professor at Webster University. Mr. Straub was previously a founder and executive team member of Fotomat Corporation, a retail film development company, from 1967-1975. Mr. Straub is Chairman of the Audit Committee and Financial Expert of the Audit Committee.

Mr. Price, Mr. Sholtis and Mr. Straub are independent directors as defined in NASD Rule 4200.

We have adopted a Code of Ethics that applies to all of our directors, officers, and employees. The Code of Ethics is posted on our website at [www.nitches.com](http://www.nitches.com). Amendments to, and waivers granted under, our Code of Ethics, if any, will be posted to our website as well.

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### Item 11 - Executive Compensation

The following table shows the compensation provided to the Chief Executive Officer and each of the other most highly-compensated executive officers who served as such at the end of fiscal 2006 and whose annual compensation exceeds \$100,000:

| Name/Title<br>Year            | Annual Compensation |       | Long Term Compensation   |                               |                          |         | All<br>Other<br>Comp. |
|-------------------------------|---------------------|-------|--------------------------|-------------------------------|--------------------------|---------|-----------------------|
|                               | Salary              | Bonus | Awards                   |                               | Payouts                  |         |                       |
|                               |                     |       | Other<br>Annual<br>Comp. | Restricted<br>Stock<br>Awards | Securities<br>Underlying | LTIP    |                       |
|                               |                     |       |                          |                               | Options/<br>SARs         | Payouts |                       |
| \$                            | \$                  | \$    | \$                       | #                             | \$                       |         |                       |
| Steven P. Wyandt<br>CEO & CFO |                     |       |                          |                               |                          |         |                       |

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|                 |         |    |    |    |    |    |    |
|-----------------|---------|----|----|----|----|----|----|
| 2006            | 250,000 | -- | -- | -- | -- | -- | -- |
| 2005            | 250,000 | -- | -- | -- | -- | -- | -- |
| 2004            | 250,000 | -- | -- | -- | -- | -- | -- |
| Paul M. Wyandt  |         |    |    |    |    |    |    |
| President & COO |         |    |    |    |    |    |    |
| 2006            | 160,000 | -- | -- | -- | -- | -- | -- |
| 2005            | 160,000 | -- | -- | -- | -- | -- | -- |
| 2004            | 160,000 | -- | -- | -- | -- | -- | -- |

There were no stock options outstanding or granted during fiscal year 2006.

The Company extended an employment agreement with Steven P. Wyandt, effective September 1, 2001 through August 31, 2004. Pursuant to this agreement, Mr. Wyandt serves as Chief Executive Officer and Chief Financial Officer of the Company. The agreement provides for a base annual salary of \$250,000, or a higher amount as the Board of Directors may approve. In addition, Mr. Wyandt may receive a bonus at the discretion of the Board of Directors. No bonus was paid to Mr. Wyandt during fiscal 2004, 2005, or 2006. The agreement continues on a month-to-month basis after August 31, 2004.

The Company entered into an employment agreement with Paul M. Wyandt, effective April 1, 2006 through March 31, 2011. Pursuant to this agreement, Mr. Wyandt serves as President and Chief Operating Officer of the Company. The agreement provides for a base annual salary of \$160,000, or a higher amount as the Board of Directors may approve. In addition, Mr. Wyandt may receive a bonus at the discretion of the Board of Directors. No bonus was paid to Mr. Wyandt during fiscal 2004, 2005, or 2006.

All directors who are not employees of the Company receive \$24,000 annually, plus \$1,000 for attendance at each Board of Directors and Committee meeting and reimbursement of reasonable expenses. The \$1,000 fee is not paid for attendance at a Committee meeting that is held the same day the Board of Directors meets nor for participation in any meeting telephonically.

#### Compensation Committee

The Compensation Committee is responsible for setting base compensation, awarding bonuses and setting the number and terms of options for the Company's executive officers and approval of the number and terms of options for all other employees. The Committee establishes base salaries for executive officers at levels that it believes are sufficient to attract and retain such executives. The Committee may use independent survey reports for comparable companies to assist in establishing the base salaries. The Committee did not meet during fiscal year 2005.

*Compensation Committee Interlocks and Insider Participation.* The Committee consisted of Mr. Price and Mr. Sholtis. Neither Mr. Price nor Mr. Sholtis is an officer or employee of the Company.

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#### Item 12 - Security Ownership of Certain Beneficial Owners and Management

The following table sets forth, as of November 30, 2006, certain information with respect to the beneficial ownership of common stock by (a) each person known by the Company to be the beneficial owner of more than 5% of its outstanding common stock, (b) the Company's directors, (c) the Company's named executive officers, and (d) all directors and executive officers as a group. Except as noted below, to the best of the Company's knowledge, each of such persons has sole voting and investment power with respect to the shares beneficially owned

| Name and Address of Beneficial Owner (1)(2)               | Amount and Nature of Beneficial Ownership (3) | Percent of Class Outstanding |
|---|---|------------------------------|
| <b>Officers and Directors</b>                             |   |                              |
| Steven P. Wyandt (4)                                      | 1,298,349                                     | 24.7%                        |
| Eugene B. Price II  | 69,417  | 1.3%                         |
| Michael. D. Sholtis                                       | 10,000  | 0.2%                         |
| All directors and current officers as a group (5 persons) | 1,377,766                                     | 26.2%                        |
| <b>5% Shareholders</b>                                    |   |                              |

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|  |         |       |
|--|---------|-------|
| Haresh T. Tharani (5)<br>1400 Broadway, 33 <sup>rd</sup> Floor<br>New York, NY 10018 | 971,000 | 18.5% |
| Arvind Singh (6)<br>3246 Story Rd.<br>Irving, TX                                     | 300,000 | 5.7%  |
| Raji Singh (6)<br>3246 Story Rd.<br>Irving, TX                                       | 300,000 | 5.7%  |

- (1) Except as otherwise indicated, the address of each beneficial owner is c/o Nitches, Inc., 10280 Camino Santa Fe, San Diego, CA 92121.
- (2) Except as otherwise indicated, the persons named in this table have sole voting and investment power with respect to all shares of common stock listed.
- (3) The securities beneficially owned by an individual are determined in accordance with the definition of beneficial ownership set forth in the regulations promulgated under the Exchange Act and, accordingly, may include securities owned by or for, among others, the spouse and/ or minor children of an individual.
- (4) A portion of the shares of Steven P. Wyandt are owned indirectly in Trusts, the terms of which establish sole voting power in Mr. Wyandt.
- (5) Includes 300,000 restricted shares (adjusted for the 200% stock dividend of January 3, 2006) that Mr. Tharani received as a result of the Company's acquisition of Designer Intimates, Inc. as well as the 600,000 restricted shares beneficially owned by Mr. Tharani through Taresha LLC that are subject to a lock-up agreement as further described in Item 13 - Certain Relationships and Related Transactions.
- (6) Includes 300,000 restricted shares registered in the name of Impex, Inc. received as a result of Nitches' recent acquisition of Saguaro LLC. The shareholder owns a 50% interest in Impex, Inc.

**Item 13 - Certain Relationships and Related Transactions**

On June 24, 2006, Nitches, Inc. ("Nitches") entered into an Asset Purchase Agreement (the "Agreement") with Taresha LLC, a New Jersey limited liability corporation ("Taresha"). Pursuant to the Agreement, Nitches acquired from Taresha substantially all of the assets of its Home Décor business as of July 1, 2006 in exchange for 600,000 shares of Nitches' common stock. As a result of this transaction, Taresha owns more than 10% of the outstanding shares of Nitches' common stock. Mr. Haresh Tharani is the controlling equity owner of Taresha. Mr. Tharani is a shareholder of Nitches, Inc. and was the controlling shareholder of Designer Intimates, Inc., which Nitches acquired on October 24, 2005. After the issuance of the 600,000 shares in connection with the Agreement, Mr. Tharani beneficially owns approximately 18.5% of the outstanding common stock of Nitches. There are no agreements or arrangements in place to appoint Mr. Tharani or any representatives of Taresha to serve on the board of directors or as an executive officer of Nitches. The 600,000 shares issued pursuant to the Agreement are subject to a lock-up agreement between Nitches and Taresha that restricts these shares from trading, voting or receiving any benefit such as dividends unless and until the remaining Nitches shareholders approve the Agreement and the stock issuance. A proxy pertaining to this shareholder approval is currently pending review and comment by the SEC.

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**Item 14 - Principal Accountant Fees and Services**

Fees billed for professional services rendered by Berenson LLP for the annual audit of our annual financial statements for fiscal 2006 and for the review of our quarterly financial statements included in our fiscal 2006 Forms 10-Q were \$153,176. Aggregate fees billed by Dunlap, Klingensmith, Dunlap & Peck for tax services, including tax planning and preparation, during fiscal 2006 was \$16,956. Fees billed for professional services rendered by Berenson LLP for the planning and review of acquisition transactions for fiscal 2006 were \$9,495.

Fees billed for professional services rendered by Berenson LLP for the annual audit of our annual financial statements for fiscal 2005 and for the review of our quarterly financial statements included in our fiscal 2005 Forms 10-Q were \$102,673. The aggregate fees billed by Moss Adams LLP for the review of fiscal 2005 financial statements included in our Forms 10-Q were \$41,167. The aggregate fees billed by Moss Adams LLP for tax services, including tax planning and preparation, during fiscal 2005 were \$34,372. The Company did not engage Berenson LLP or Moss Adams LLP on any other matters not otherwise included in the above categories in either fiscal 2006 or 2005.

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**PART IV**

**Item 15 - Exhibits, Financial Statement Schedules and Reports on Form 8-K**

(a) Documents filed as part of this report:

1. The following consolidated financial statements of the Registrant are included as part of this report:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of August 31, 2006 and 2005;

Consolidated Statements of Income for the years ended August 31, 2006, 2005 and 2004;

Consolidated Statements of Shareholders' Equity for the years ended August 31, 2006, 2005 and 2004;

Consolidated Statements of Cash Flows for the years ended August 31, 2006, 2005 and 2004;

Notes to Consolidated Financial Statements

2. The following financial statement schedules of the Registrant are included as part of this report:

Report of independent auditors on Schedule II

Schedule II - Valuation and Qualifying Accounts and Reserves

All other schedules are omitted because they are not required, are inapplicable or the information is otherwise shown in the financial statements or notes thereto.

3. The following exhibits are filed herewith or incorporated by reference as indicated. Exhibit numbers refer to Item 601 of Regulation S-K:

- 3.1 Articles of Incorporation of the Company, as amended (1)
- 3.2 Bylaws of the Company, as amended (2)
- 10.1 Form of Indemnification Agreement for Officers and Directors (1)
- 10.2 Employment Agreement with Steven P. Wyandt (3)
- 10.3 Employment Agreement with Paul M. Wyandt (4)
- 10.4 Asset Purchase Agreement and related agreements between the Company and Design and Source Holding Company, Ltd. effective July 1, 1995 (5)
- 10.5 Stock Sale and Purchase Agreement dated October 24, 2005, between the Company and the shareholders of Designer Intimates, Inc. (6)
- 10.6 Acquisition Agreement dated as of June 23, 2006, between the Company and Impex, Inc. (7)
- 10.7 Amendment No. 1 to Acquisition Agreement dated as of June 23, 2006, between the Company and Impex, Inc. (8)
- 10.8 Asset Purchase Agreement dated as of June 24, 2006, between the Company and Taresha LLC(9)

(b) Exhibits and Reports on Form 8-K. None

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**Footnotes**

- (1) Incorporated by reference from Registrant's Form 10-K filed on November 23, 1992 for the fiscal year ended August 31, 1992.
- (2) Incorporated by reference from Registrant's Form 10-K filed on November 23, 1988 for the fiscal year ended August 31, 1988.
- (3) Incorporated by reference in Schedule 13E-4 filed on August 18, 1998 and amendments related thereto.
- (4) Incorporated by reference from Registrant's Form 8-K filed on March 22, 2006.
- (5) Incorporated by reference from Registrant's Form 10-K filed on November 3, 1995 for the fiscal year ended August 31, 1995.
- (6) Incorporated by reference from Registrant's Form 8-K/A filed on January 10, 2006.
- (7) Incorporated by reference from Registrant's Registration Statement on Form S-3/A filed on September 15, 2006.
- (8) Incorporated by reference from Registrant's Form 8-K filed on August 8, 2006.
- (9) Incorporated by reference from Registrant's Preliminary Form 14A filed on November 7, 2006.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, there unto duly authorized.

Date: January 31, 2007

**NITCHES, INC.**

By: /s/ Steven P. Wyandt  
Steven P. Wyandt, Chairman

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

|  |  |                  |
|--|--|------------------|
| /s/ Steven P. Wyandt<br>Steven P. Wyandt | Chief Executive Officer<br>(Principal Executive Officer), Chief<br>Financial Officer (Principal Financial<br>Officer) and Director | January 31, 2007 |
|--|--|------------------|

|                                      |  |                  |
|--------------------------------------|--|------------------|
| /s/ Paul M. Wyandt<br>Paul M. Wyandt | President, Chief Operating Officer<br>(Principal Operating Officer), and<br>Director | January 31, 2007 |
|--------------------------------------|--|------------------|

|  |          |                  |
|--|----------|------------------|
| /s/ Eugene B. Price II<br>Eugene B. Price II   | Director | January 31, 2007 |
| /s/ Michael Sholtis<br>Michael Sholtis         | Director | January 31, 2007 |
| /s/ T. Jefferson Straub<br>T. Jefferson Straub | Director | January 31, 2007 |

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders  
Nitches, Inc. and Subsidiaries  
San Diego, California

Our audit of the consolidated financial statements of Nitches, Inc. and Subsidiaries referred to in our report dated November 15, 2006 appearing in item 8 in this Annual Report of Form 10-K also included an audit of the information for the years ended August 31, 2005 and 2006 included in the financial statement schedule listed in item 15 of this Form 10-K. In our opinion, the information for the years ended August 31, 2005 and 2006 included in the financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

Berenson LLP

New York, New York  
November 15, 2006

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders  
Nitches, Inc. and Subsidiaries  
San Diego, California

Our audit of the consolidated statements of income, shareholders' equity and cash flows of Nitches, Inc. and Subsidiaries referred to in our report dated October 22, 2004 appearing in item 8 in this Annual Report of Form 10-K also included an audit of the information included in the financial statement schedule listed in item 14(a) of this Form 10-K. In our opinion, the information included in the financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

MOSS ADAMS LLP

Los Angeles, California  
October 22, 2004

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Schedule II

NITCHES, INC.

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Valuation and Qualifying Accounts and Reserves

|   | Balance at<br>Beginning<br>of Year | Charged to<br>Costs and<br>Expenses | Charged to<br>Other<br>Accounts | Deductions | Balance at<br>End of Year |
|---|------------------------------------|-------------------------------------|---------------------------------|------------|---------------------------|
| <b>Year ended August 31, 2004</b>               |                                    |                                     |                                 |            |                           |
| Allowance for doubtful accounts & sales returns | \$549,000                          | \$330,000                           | -                               | \$387,000  | \$492,000                 |
| Inventory markdown allowance                    | \$140,000                          | \$118,000                           | -                               | \$173,000  | \$85,000                  |
| <b>Year ended August 31, 2005</b>               |                                    |                                     |                                 |            |                           |
| Allowance for doubtful accounts & sales returns | \$492,000                          | \$318,000                           | -                               | \$538,000  | \$272,000                 |
| Inventory markdown allowance                    | \$85,000                           | \$61,000                            | -                               | \$61,000   | \$85,000                  |
| <b>Year ended August 31, 2006</b>               |                                    |                                     |                                 |            |                           |
| Allowance for doubtful accounts & sales returns | \$272,000                          | \$242,000                           | \$300,000                       | \$171,000  | \$643,000                 |
| Inventory markdown allowance                    | \$85,000                           | \$117,000                           | \$340,000                       | \$154,000  | \$388,000                 |

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EXHIBIT INDEX

| Exhibit<br>Number | Exhibit  |
|-------------------|--|
| * 3.1             | Articles of Incorporation of the Company, as amended (1)   |
| * 3.2             | Bylaws of the Company, as amended (2)  |
| * 10.1            | Form of Indemnification Agreement for Officers and Directors (1)   |
| * 10.2            | Employment Agreement with Steven P. Wyandt (3)   |
| * 10.3            | Employment Agreement with Paul M. Wyandt (4)   |
| * 10.4            | Asset Purchase Agreement and related agreements between the Company and Design and Source Holding Company, Ltd. effective July 1, 1995 (5) |
| * 10.5            | Stock Sale and Purchase Agreement dated October 24, 2005, between the Company and the shareholders of Designer Intimates, Inc. (6)         |
| * 10.6            | Acquisition Agreement dated as of June 23, 2006, between the Company and Impex, Inc. (7)   |
| * 10.7            | Amendment No. 1 to Acquisition Agreement dated as of June 23, 2006, between the Company and Impex, Inc. (8)                                |
| * 10.8            | Asset Purchase Agreement dated as of June 24, 2006, between the Company and Taresha LLC(9)   |
| 31                | Certification required under Section 302   |
| 32                | Certification required under Section 906   |

\* Incorporated by reference

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