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Flooring Zone Inc
Form 10QSB
December 30, 2005

United States
Securities and Exchange Commission
Washington, DC 20549

FORM 10-QSB

Quarterly Report Under Section 13 or 15(d) of
the Securities Exchange Act of 1934

For the Quarter Ended
September 30, 2005

Commission File Number
333-119234

THE FLOORING ZONE, INC.

(Exact name of registrant as specified in its charter)

NEVADA

(State or other jurisdiction of incorporation or organization)

20-0019425

(I.R.S. Employer Identification No.)

3219 Glynn Avenue, Brunswick, Georgia 31520

(Address of principal executive offices)

(912) 264-0505

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12 (b) of the Act: None.

Securities registered pursuant to section 12(g) of the Exchange Act: Common,
\$0.001 par value

Check whether the Issuer filed all reports required to be filed by section 13 or
15(d) of the Exchange Act during the past 12 months (or for such shorter period
that the registrant was required to file such report(s), Yes No

Check whether the Issuer has been subject to such filing requirements for the
past 90 days. Yes No

As of December 23, 2005 we had 38,569,250 shares of our \$0.001 par value, common
stock outstanding.

THE FLOORING ZONE, INC.

FORM 10-QSB

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

The Flooring Zone, Inc.
Condensed Consolidated Balance Sheet
September 30, 2005
(Unaudited)

ASSETS

Current assets:

| | | |
|---------------------------|-------|---|
| Cash | \$ | |
| Accounts receivable, net | | 1 |
| Inventory | | 5 |
| Prepaid expense | | |
| Total current assets | ----- | 7 |
| Property & equipment, net | | 2 |

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Other assets:

| | |
|------------------------|--------------------------|
| Intangible assets, net | |
| Deposits | |
| Total other assets | ----- |
| TOTAL ASSETS | ----- \$ 1,0 ===== |

See accompanying notes to financial statements

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The Flooring Zone, Inc.
Condensed Consolidated Balance Sheet-[continued]
September 30, 2005
(Unaudited)

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current liabilities:

| | |
|--------------------------------|------------|
| Accounts payable | \$ 5 |
| Line of credit-bank | 2 |
| Line of credit-related party | |
| Customer deposits | |
| Accrued liabilities | |
| Current portion long-term debt | 1 |
| Total current liabilities | ----- 9 |

Long-term liabilities:

| | |
|--------------------------------|------------|
| Note payable-related party | 1 |
| Long-term debt | 6 |
| Current portion long-term debt | (1) |
| Total long-term liabilities | ----- 6 |
| Total liabilities | 1,5 |

Stockholders' deficit:-Note 2

Preferred Stock, 10,000,000 shares authorized \$.001 par value
value: No shares issued and outstanding

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Common stock, 100,000,000 shares authorized \$.001 par value; 38,569,250 shares issued and outstanding

| | |
|---|--------|
| Additional paid in capital | 6 |
| Accumulated deficit | (1,1) |
| | ----- |
| Total stockholders' deficit | (5) |
| | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT | \$ 1,0 |
| | ===== |

See accompanying notes to financial statements

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The Flooring Zone, Inc.
Condensed Consolidated Statements of Operations
For the three month and nine month periods ended
September 30, 2005 and 2004
(Unaudited)

| | Three months ended September 30, | | Nine mon Septem |
|-------------------------------------|-------------------------------------|------------|--------------------|
| | 2005 | 2004 | 2005 |
| | ----- | ----- | ----- |
| Revenues: | | | |
| Sales | \$ 788,714 | \$ 922,271 | \$ 2,573,3 |
| Licensing Fees | - | - | 2,5 |
| Net revenues | 788,714 | 922,271 | 2,575,8 |
| Less cost of sales | 669,427 | 644,241 | 1,761,2 |
| Gross profit | 119,287 | 278,030 | 814,6 |
| General and administrative expenses | 310,856 | 306,877 | 952,1 |
| Net income (loss) from operations | (191,569) | (28,847) | (137,5 |
| Other income (expense): | | | |
| Interest expense | (18,712) | (14,708) | (62,5 |
| Total other income (expense) | (18,712) | (14,708) | (62,5 |
| Net income (loss) before taxes | (210,281) | (43,555) | (200,1 |
| Income taxes | - | - | |

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| | | | | | | |
|---|----|------------|----|------------|----|------------|
| Net income (loss) | \$ | (210,281) | \$ | (43,555) | \$ | (200,113) |
| Income (loss) per share-basic and diluted | \$ | (0.01) | \$ | (0.01) | \$ | (0.01) |
| Weighted average shares outstanding-basic and diluted | | 38,560,572 | | 38,428,700 | | 38,494,600 |

See accompanying notes to financial statements

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The Flooring Zone, Inc.
Condensed Consolidated Statements of Cash Flows
For the nine month periods ended
September 30, 2005 and 2004
(Unaudited)

| | 9/30/2005 |
|--|--------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | |
| Net income (loss) | \$ (200,113) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: | |
| Depreciation and amortization | 32,070 |
| Decrease (increase) in accounts receivable | 1,381 |
| Decrease (increase) in inventories | (242,971) |
| Decrease (increase) in prepaid expenses | 65,571 |
| Decrease (increase) in deferred financing costs | - |
| Increase (decrease) in accounts payable | (17,143) |
| Increase (decrease) in accrued liabilities | (295) |
| Increase (decrease) in customer deposits | 18,052 |
| Net cash used in operating activities | (343,448) |
| CASH FLOWS FROM INVESTING ACTIVITIES | |
| Purchase of property and equipment | (7,748) |
| Purchase of intangible assets | - |

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| | | |
|---|----|-----------|
| Net cash used in investing activities | | (7,748) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net borrowing(payments) on line of credit-related party | | 210,361 |
| Net borrowing(payments) on long term debt | | (127,823) |
| Proceeds from borrowing on long term debt | | - |
| Proceeds from the issuance of common stock (less costs) | | 201,593 |
| | | ----- |
| Net cash provided by financing activities | | 284,131 |
| | | ----- |
| NET INCREASE IN CASH | | (67,065) |
| CASH AT BEGINNING OF PERIOD | | 90,092 |
| | | ----- |
| CASH AT END OF PERIOD | \$ | 23,027 |
| | | ===== |
| SUPPLEMENTAL DISCLOSURES | | |
| Cash paid for interest | \$ | 58,589 |
| Cash paid for income taxes | | - |
| NON-CASH FINANCING ACTIVITIES | | |
| Trade payables converted to notes payable | \$ | |

See accompanying notes to financial statements

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The Flooring Zone, Inc.
Notes to Condensed Consolidated Financial Statements
September 30, 2005

Note 1 ORGANIZATION AND INTERIM FINANCIAL STATEMENTS

Organization - The Flooring Zone, Inc. (the "Company") is a corporation organized under the laws of the State of Nevada on May 5, 2003. The company's business operations provide for full-service retail floor covering products and services.

Interim financial statements - The accompanying condensed consolidated financial statements are unaudited and have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles for complete financial statements generally accepted in the United States of America. In the opinion of management, the accompanying consolidated financial statements contain all adjustments, consisting of normal recurring

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accruals, necessary for a fair presentation of our financial position as of September 30, 2005. There has not been any change in the significant accounting policies of The Flooring Zone, Inc. for the periods presented. The results of operations for the three months and nine months ended September 30, 2005 and 2004 are not necessarily indicative of the results for a full-year period. It is suggested that these unaudited condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2004 filed with the Securities and Exchange Commission (the "SEC").

Stock based compensation - The Company accounts for stock compensation arrangements under the intrinsic value method outlined in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, (APB Opinion No. 25) and currently intends to continue to do so until it adopts the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment, (SFAS No. 123R). Accordingly, no compensation cost has been recognized for stock compensation arrangements. If the compensation cost for the compensation plans had been determined consistent with SFAS No. 123R, net income and earnings per common share and common share equivalent would have changed to the pro forma amounts indicated below:

| | 9/30/2005 | 9/30/2004 |
|--|--------------|-----------|
| | ----- | ----- |
| Net income (loss), as reported | \$ (200,113) | \$ 15,635 |
| Compensation cost under fair value-based accounting method, net of tax | - | - |
| | ----- | ----- |
| Net loss, pro forma | (200,113) | 15,635 |
| Net loss per share-basic and diluted: | | |
| As reported | \$ (0.01) | \$ 0.00 |
| Pro forma | \$ (0.01) | \$ 0.00 |

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The Flooring Zone, Inc.
Notes to Condensed Consolidated Financial Statements
September 30, 2005
(Unaudited)

Note 2 COMMON STOCK

The Company's SB-2 Registration statement filed with the Securities and Exchange Commission became effective in January 2005. During the nine months ended September 30, 2005 the Company issued 140,550 shares of its common stock at a price of \$2.00 per share for a total of \$281,100.

Note 3 INVENTORY

Inventories are stated at lower of cost or market and consist of the following:

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9/30/05

| | |
|-------------------|------------|
| Flooring material | 546,145 |
| Total | \$ 546,145 |

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion summarizes the significant factors affecting our consolidated operating results, financial condition, liquidity and capital resources during the three and nine months ended September 30, 2005 and 2004. This discussion should be read in conjunction with the financial statements and financial statement footnotes included in this registration statement.

Forward-Looking Statements

Certain statements of our expectations contained herein, including, but not limited to statements regarding sales growth, new stores, increases in comparable store sales, commodity price inflation and deflation, and capital expenditures constitute "forward-looking statements." Such statements are based on currently available operating, financial and competitive information and are subject to various risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations. These risks and uncertainties include but are not limited to, fluctuations in and the overall condition of the U.S. economy, stability of costs and availability of sourcing channels, conditions affecting new store development, our ability to implement new technologies and processes, our ability to attract, train, and retain highly-qualified associates, unanticipated weather conditions and the impact of competition and regulatory and litigation matters. Undue reliance should not be placed on such forward-looking statements, as such statements speak only as of the date on which they are made.

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General

The Flooring Zone, Inc. is a Nevada corporation organized on May 5, 2003, to operate full service retail floorcovering stores. We have a wholly-owned subsidiary, The Flooring Zone of Georgia, Inc. The Georgia Corporation was formed in 2000, by the founders of The Flooring Zone, Inc., and was established to develop our business concept in the retail floorcovering industry. Through our subsidiary we operate two retail stores. We have stores in Brunswick, Georgia and Yulee, Florida. We also maintain administrative offices and warehouse facilities in Brunswick, Georgia. We recently closed our store in St. Mary's, Georgia because of poor performance.

We recently completed our registered public offering. In the offering we raised total proceeds of \$281,100. The primary purpose of our public offering was to raise capital to expand our operations and store locations in the southeastern United States. Unfortunately, we were unsuccessful in raising sufficient funds to warrant expansion into other markets at this time. Therefore, we now plan to focus our efforts on increasing sales at our current locations, reducing our debt load and funding expansion with net profits from operations. Based thereon, we do not anticipate expanding to new locations until such time as net profits from operations justifies future expansion.

Results of Operations

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For the nine months ended September 30, 2005 and 2004

We have incurred a net loss through the first nine months of 2005, compared to net income during the same nine month period 2004.

Revenues

We generate revenue primarily from the sale of flooring products. We sell flooring products to two groups - retail customers and contractors. Retail customers generally pay higher prices for products than contractors. Typically, about 70% of our product sales are to retail customers and 30% of our product sales are to contractors.

Despite average retail product prices being approximately 10% higher, during the nine months ended September 30, 2005 compared to the same nine month period of 2004, we realized a decrease in revenues of 12% to \$2,575,895. This decrease in revenue in the first nine months of 2005 was primarily the result of an unusually successful first fiscal quarter of 2004, when we provided flooring products for a large condominium complex and a local hospital. While overall revenue decreased 12%, we believe that, exclusive of the condominium project and the hospital, our revenue from product sales in the first nine months of 2005 is somewhat lower when compared with revenues from the first nine months of 2004.

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As noted above, our revenues are affected by consumer confidence. Based on sales during the first nine months, we believe consumer confidence in the communities where we operate continues to be strong. We anticipate revenues at our current stores to remain constant or even slightly higher during the remainder of 2005.

Gross Profit

Our gross profit is directly affected by our costs of sales. Cost of sales includes all direct costs of floor coverings, materials used in installation and installation labor. As with revenues, our cost of sales and gross profit are directly affected by changes in the percentage of products sold to retail customers versus contractors. As discussed above, the prices we can charge contractors are lower than the prices we can charge retail customers, therefore, our profit margin on product sales to retail customers is greater. Moreover, we typically also realize profit from the sale of materials used in installation and from the costs charged for installation labor to retail customers. Conversely, contractors typically use their own subcontractors to install the floor covering products they purchase. These subcontractors provide the materials used in installation and the installation labor.

Gross profit during the first nine months of 2005, was \$814,639, 24% lower than the \$1,066,987 gross profits realized during the first nine months of 2004. During the first nine month of 2005, we realized a 12% decrease in net revenue. We also realized a 6% decrease in cost of sales during that period. Cost of sales as a percentage of net revenues increased approximately 5% during the 2005 period compared to the 2004 period. Until such time as we are able to expand our operations into additional markets, we anticipate gross profit to remain consistent with the prior year results or to increase modestly.

General and Administrative Expenses

Comparison of the nine months ended September 30, 2005 and 2004

General and administrative expenses for the nine months ended September 30, 2005, decreased \$53,455, or 5% to \$952,160 compared to the nine months ended

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September 30, 2004, and as a percentage of sales revenue increased approximately 3% during the nine months ended September 30, 2005 and 2004. During the nine months ended September 30, 2005 and 2004, general and administrative costs consisted of:

| | Nine Months Ended | |
|-----------------------------|--------------------|--------------------|
| | September 30, 2005 | September 30, 2004 |
| Salaries & benefits costs | \$ 383,949 | \$ 463,072 |
| Advertising & display costs | 73,647 | 57,049 |
| Occupancy costs & utilities | 235,010 | 223,497 |
| Legal & accounting costs | 41,505 | 38,340 |
| Other | 218,049 | 223,657 |
| | \$ 952,160 | \$ 1,005,615 |
| | \$ 952,160 | \$ 1,005,615 |

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The 17% reduction in salaries and benefits costs in the nine months ended September 30, 2005 compared to 2004 is largely the result of a reduction in our work force as we have made a concerted effort to consolidate certain job functions. We do not anticipate significant increases in staffing needs until we have raised sufficient capital to expand our operations.

During the nine months ended September 30, 2005 we increased our advertising and display costs by 29% compared to the same period of 2004. This increase in advertising is largely attributable to our efforts to increase product sales and our efforts to inform investors of our ongoing public offering. We anticipate advertising costs to be reduced in upcoming quarters.

Occupancy costs and utilities during the nine months ended September 30, 2005 compared to the same period of 2004, increased 6%. We expect these costs to remain relatively constant in the upcoming quarters.

Legal and accounting costs increased 8% to \$41,505 during the nine month period ended September 30, 2005 compared to the nine month period ended September 30, 2004. We anticipate legal and accounting costs to continue at levels consistent with or higher than the amounts incurred in the first nine months of 2005 as we begin to incur legal and accounting costs in connection with our ongoing public reporting obligations.

Other costs remained relatively constant decreasing about 3% during the nine months ended September 30, 2005 compared to September 30, 2004. We anticipate other expenses to remain fairly constant in upcoming quarters.

Net Loss

Our net loss in the nine months ended September 30, 2005 was \$200,113 compared to net income of \$15,635 during the first nine months of 2004. This change from net income to a net loss during the first nine months of 2005 is primarily the result of decreased sales volume and increased cost of sales compared to the first nine months of 2004 as the Company completed a number of unusually large jobs during the first nine months of 2004.

Comparison of the three months ended September 30, 2005 and 2004.

During the three months ended September 30, 2005, we incurred greater net losses compared to the months ended September 30, 2004.

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Revenues

Revenue decreased 14% during the three months ended September 30, 2005 compared to the same three month period of 2004. This decrease in revenue in the third fiscal quarter 2005 was primarily the result of decreased product sales during the third fiscal quarter of 2005 compared to the third fiscal quarter of 2004.

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Gross Profit

Gross profit during the third fiscal quarter of 2005, was \$119,287, a 57% decrease compared to the gross profit realized during the third fiscal quarter of 2004, as net revenue decreased 14%, while cost of sales increased 4% during the third fiscal quarter of 2005. The decrease in gross profit was largely impacted by an increase in costs of materials due to a surge in fuels prices. The Company also experienced an increase in installation labor due to fuel costs and a number of jobs that required multiple visits by the installers. The Company anticipates the gross profit to increase modestly in upcoming quarters.

General and Administrative Expenses

For the three months ended September 30, 2005 and 2004

General and administrative expenses for the three months ended September 30, 2005, increased \$3,979, or 1% to \$310,856 compared to the three months ended September 30, 2004. As a percentage of sales revenue general and administrative expenses increased to 39% during the quarter ended September 30, 2005, compared to 33% during the quarter ended September 30, 2004. During the three months ended September 30, 2005 and 2004, general and administrative costs consisted of:

| | Three Months Ended | |
|-----------------------------|--------------------|--------------------|
| | September 30, 2005 | September 30, 2004 |
| | ----- | ----- |
| Salaries & benefits costs | \$ 133,803 | \$ 151,994 |
| Advertising & display costs | 24,211 | 10,108 |
| Occupancy costs & utilities | 84,018 | 74,660 |
| Legal & accounting costs | 5,697 | 5,869 |
| Other | 63,127 | 64,246 |
| | ----- | ----- |
| | \$ 310,856 | \$ 306,877 |
| | ===== | ===== |

The 12% reduction in salaries and benefits costs in the quarter ended September 30, 2005 compared to the quarter ended September 30, 2004 is largely the result of a reduction in our administrative work force as we have made a concerted effort to control costs through the consolidation of certain job functions. We do not anticipate significant increases in staffing needs until we have raised sufficient capital to expand our operations.

During the three months ended September 30, 2005 we increased our advertising and display costs by 140% to \$24,211 compared to the same period of 2004 in an effort to increase sales and in connection with our public offering. We anticipate advertising to return to more traditional levels in upcoming quarters.

Occupancy costs and utilities during the third quarter 2005 compared to

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the same quarter 2004, increased 13%. We expect these costs to remain relatively consistent in the upcoming quarters.

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Legal and accounting costs remained constant, decreasing less than 3% during the three months ended September 30, 2005 compared to the three months ended September 30, 2004. We expect this more the result of timing than of any trend toward reducing legal and accounting costs. We anticipate legal and accounting costs to continue at levels consistent with or higher than those we have experienced during the year as a result of our ongoing public reporting obligations.

Other costs were relatively unchanged during the quarters ended September 30, 2005 and 2004 decreasing less than 2% in the third quarter of the current year. We anticipate other expenses to remain relatively constant in upcoming quarters.

Net Loss

Our net loss in the third quarter 2005 was \$210,281 compared to a net loss of \$43,555 in the third quarter 2004. This significant increase in net loss is primarily the result of small increases in cost of sales and general and administrative expenses, coupled with a significant decrease in sales volume and increased interest expense compared to the third quarter 2004.

Liquidity and Capital Resources

Our capital resources have consisted of revenues from operations, funds raised through the sale of our common stock and debt. On January 31, 2005 our SB-2 registration statement was declared effective by the Securities and Exchange Commission and we commenced selling shares of our common stock at \$2.00 per share. As of September 30, 2005, we have raised \$281,100. We anticipate our capital resources in the upcoming twelve months will likewise consist primarily of revenues from operations, funds raised in financing activities and debt.

During the first nine months of 2005 and 2004 cash was primarily used to fund operations. See below for additional discussion and analysis of cash flow.

| | Nine Months Ended | |
|---|--------------------|--------------------|
| | September 30, 2005 | September 30, 2004 |
| | ----- | ----- |
| Net cash used in operating activities | \$ (343,448) | \$ (171,314) |
| Net cash used in investing activities | \$ (7,748) | \$ (4,349) |
| Net cash provided by financing activities | \$ 284,131 | \$ 192,144 |
| | ----- | ----- |
| | \$ (67,065) | \$ 16,481 |
| | ===== | ===== |

NET INCREASE (DECREASE) IN CASH

As discussed herein, during the nine months ended September 30, 2005 compared to the nine months ended September 30, 2004 product sales decreased leading to a change from net income of \$15,635 during the nine month period of 2004 to a \$200,113 net loss during the nine month period of 2005. During the first nine months of 2005 inventory has increased \$242,971 due to price

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increases from higher fuel costs and an unusually large number of jobs still in progress at the end of the quarter but not yet completed. Accounts payable decreased \$17,143. Prepaid expenses have decreased \$65,571 because prepaid expenses related to the ongoing public offering were charged to additional paid in capital this period. Net cash used in operating activities during the nine months ended September 30, 2005, was 100% higher than net cash used in operating activities during the nine months ended September 2004. This increase in cash used in operating activities during the nine months ended September 30, 2005, was largely the result of circumstances explained above.

We used \$7,748 net cash in investing activities to acquire equipment during the first nine months of 2005, compared to \$4,349 during the first nine months of 2004.

Net cash provided from financing activities was \$284,131 during the nine months ended September 30, 2005 compared to \$192,144 during the nine months ended September 30, 2004, a 48% increase. During the nine months ended September 30, 2005 we repaid \$127,823 in long term debt compared to \$341,356 during the first nine months of 2004. We also borrowed \$210,361 on a line of credit from a related party during the first nine months of 2005, whereas in the first nine months of 2004, we reduced the outstanding balance on the line of credit by \$124,000. Also during the first nine months of 2005, we raised \$281,100 from the sale of our common stock in a public offering compared to funds raised in private sales of our common stock totaling \$107,500 during the nine months ended September 30, 2004.

At September 30, 2005 and 2004, we had cash on hand of \$23,027 and \$71,495, respectively.

Summary of Material Contractual Commitments

The following table lists our significant commitments as of September 30, 2005.

| Contractual Commitments | Total | Payments Due by Fiscal Year | | | | Thereaf |
|----------------------------|-------------|-----------------------------|-----------|-----------|-----------|---------|
| | | 2005 | 2006 | 2007 | 2008 | |
| Note Payable-Related Party | 110,378 | 15,333 | 47,414 | 47,631 | -- | |
| Notes Payable | 557,448 | 62,214 | 44,373 | 47,344 | 50,515 | 353,0 |
| Capital Leases | 21,176 | 2,670 | 10,473 | 8,034 | -- | |
| Operating Leases | 753,323 | 97,133 | 199,534 | 149,388 | 152,170 | 155,0 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| TOTAL | \$1,442,325 | \$177,350 | \$301,794 | \$252,397 | \$202,685 | \$508,1 |
| | ===== | ===== | ===== | ===== | ===== | ===== |

Off-Balance Sheet Financing Arrangements

As of September 30, 2005 and 2004, we had no off-balance sheet financing arrangements.

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Critical Accounting Policies

Revenue Recognition

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We recognize revenues in accordance with the Securities and Exchange Commission, Staff Accounting Bulletin (SAB) number 104, "Revenue Recognition in Financial Statements." SAB 104 clarifies application of U.S. generally accepted accounting principles to revenue transactions. Accordingly, revenue is recognized when an order has been received, the price is fixed and determinable, the order is shipped and installed, collection is reasonably assured and we have no significant obligations remaining. Licensing fees are royalties paid to us for licensing the use of the name The Flooring Zone. The royalties range from 1-2% of the licensee's commercial sales volume.

We record accounts receivable for sales which have been delivered but for which money has not been collected. An allowance for doubtful accounts is provided for accounts deemed potentially uncollectible based on analysis and aging of accounts. For customer purchases or deposits paid in advance, we record a liability until products are shipped or installed.

Merchandise Inventory

We record inventory at the lower of cost or market, cost being determined on a first-in, first-out method. We do not believe our merchandise inventories are subject to significant risk of obsolescence in the near-term, and we have the ability to adjust purchasing practices based on anticipated sales trends and general economic conditions.

Vendor Funds

We receive funds from vendors in the normal course of business for purchase-volume-related rebates. Our accounting treatment for these vendor-provided funds is consistent with Emerging Issues Task Force (EITF) 02-16 "Accounting by a Customer (Including a Reseller) for Certain Consideration Received From a Vendor." Under EITF 02-16, purchase volume rebates should be treated as a reduction of inventory cost, unless they represent a reimbursement of specific, incremental and identifiable costs incurred by the customer to sell the vendor's product. The purchase volume rebates that we receive do not meet the specific, incremental and identifiable criteria in EITF 02-16. Therefore, they are treated as a reduction in the cost of inventory and we recognize these funds as a reduction of cost of sales when the inventory is sold.

Recently Issued Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123R, Share-based Payment. This standard is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123R requires the measurement of the cost of employee services received in exchange for an award of the entity's equity instruments based on the grant-date fair value of the award. The cost will be recognized over the period during which an employee is required to provide service in

exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render service. The Company will adopt SFAS No. 123R on December 15, 2005, which will require stock-based compensation expense to be recognized against earnings for the portion of outstanding unvested awards, based on the grant date fair value of those awards calculated using a Black-Scholes pricing model under SFAS 123 for pro forma disclosure. The Company is currently evaluating to what extent the entity's equity instruments will be used in the future for employee services and the transition provisions of this standard; therefore, the impact to the Company's financial statements of

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the adoption of SFAS No. 123R cannot be predicted with certainty.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, Inventory Pricing, to clarify that for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage), should be expensed as incurred and not included in overhead. In addition, this Statement requires the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions in SFAS No. 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is currently assessing the impact of SFAS no. 151 on its consolidated financial statements.

In December 2004, the FASB issued Staff Position No. FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004 (the "Act") that provides a tax deduction on qualified production activities. Accordingly FASB indicated that this deduction should be accounted for as a special deduction in accordance with FASB Statement No. 109. The Company will comply with the provisions of FSP 109-1 effective January 1, 2005, and does not believe that the adoption of this FASB Staff Position will have a material impact on the Company's financial statements.

Item 3. Controls and Procedures

Our principal executive officers and our principal financial officer (the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Such officers have concluded (based upon their evaluations of these controls and procedures as of the end of the period covered by this report) that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by it in this report is accumulated and communicated to management, including the Certifying Officers as appropriate, to allow timely decisions regarding required disclosure.

The Certifying Officers have also indicated that there were no significant changes in the Company's internal controls over financial reporting or other factors that could significantly affect such controls subsequent to the date of their evaluation, and there were no significant deficiencies and material weaknesses.

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Management, including the Certifying Officers, does not expect that the Company's disclosure controls or its internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. 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 a company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. The design of any systems of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of these inherent limitations in a cost-effective control system, misstatements due to

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error or fraud may occur and may not be detected.

PART II - OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

No instruments defining the rights of the holders of any class of registered securities have been materially modified, limited or qualified during the quarter ended September 30, 2005.

During the quarter, we sold no shares that were not registered under the Securities Act of 1933.

We are currently undertaking a public offering of a maximum of 10,000,000 shares of our common stock at a price of \$2.00 per share, for an aggregate offering of up to \$20,000,000. This public offering was registered with the Securities and Exchange Commission pursuant to an SB-2 registration statement. Our SB-2 registration statement was declared effective by the Securities and Exchange Commission on January 31, 2005 and we commenced our public offering at that time. The commission file number assigned to this registration statement is 333-119234.

As of September 30, 2005, we had sold 140,450 common shares raising \$281,100. Under the terms of the offering, the offering terminated on October 28, 2005. We sold no additional shares during the period from September 20, 2005 to October 28, 2005.

The offering was completely self underwritten and was by our officers and directors. No underwriting discounts and commissions, finders' fees or expenses were paid.

In accordance with the use of proceeds set forth in the registration statement, as of December 1, 2005, all of the funds raised in the offering have been used to reduce outstanding debt obligations of the Company. Of the \$281,100, approximately \$29,000 was paid to reduce amounts owed on a line of credit extended to us by Michael Carroll and a note payable to Michael Carroll. Mr. Carroll is an officer and director of the Company.

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Item 5. Other Information

As disclosed in our Current Report on Form 8-K filed on November 9, 2005, Jimmy Lee, our CEO, president and director, resigned from all positions with the Company and with our wholly-owned subsidiary, The Flooring Zone of Georgia. Mr. Lee's resignation was not the result of an disagreement on any matter relating to the Company's operations, policies or practices.

As a result of Mr. Lee's resignation, on November 4, 2005, our board of directors appointed Joel Arline to fill the vacancy on the board of directors created by Mr. Lee's resignation. At the same time, the board appointed Michael Carroll to act as our interim CEO and president. At a subsequent board meeting the board appointed Mike Carroll to act as the Company's CEO and president on a full time basis. Upon being appointed as CEO and president, Mr. Carroll resigned as our CFO and the board appointed Steve Nichols, a Company vice president to serve as our CFO.

Following is a brief description of the business background of Mr.

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Arline:

Mr. Arline is a Certified Public Accountant in Brunswick, GA. He is the President and Owner of Joel K. Arline, CPA, PC, an accounting firm he founded in 1997. Mr. Arline earned a BBA from Valdosta State University. The CPA firm owned by Mr. Arline, performs audit, review and compilation engagements and also performs tax preparation and consulting for its broad base of clients. Mr. Arline is not a director of any other SEC reporting company. Mr. Arline is 36 years old.

There are no family relationships among any of our officers or directors.

Item 6. Exhibits

Exhibits. The following exhibits are included as part of this report:

- Exhibit 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.1 Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.2 Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

THE FLOORING ZONE, INC.

December 28, 2005

/s/ Michael Carroll

Michael Carroll, Chief Executive Officer

December 28, 2005

/s/ Steven Nichols

Steven Nichols, Chief Financial Officer