AETHER HOLDINGS INC
Form 10-Q
November 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2006

Or

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

Commission File Number: **000-27707**

NEXCEN BRANDS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**20-2783217** (IRS Employer Identification Number)
1330 Avenue of the Americas, 40th Floor, New York, NY (Address of principal executive offices)	**10019-5400** (Zip Code)

(Registrant s telephone number, including area code): **(212) 277-1100**

Aether Holdings, Inc.

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	o	Accelerated filer	x	Non-accelerated filer	o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

As of October 31, 2006, 46,534,296 shares of the Registrant s common stock, \$.01 par value per share, were outstanding.

NEXCEN BRANDS, INC.
QUARTERLY REPORT ON FORM 10-Q
THE QUARTER ENDED SEPTEMBER 30, 2006

INDEX

PART I FINANCIAL INFORMATION

ITEM I: FINANCIAL STATEMENTS

NEXCEN BRANDS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

	September 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Cash and cash equivalents	$ 36,561	$ 1,092
Mortgage-backed securities, at fair value	80,236	253,900
Interest receivable	544	1,174
Restricted cash	8,633	8,633
Property and equipment, net	228	255
Prepaid expenses and other assets	1,133	954
Goodwill	10,050	
Intangible assets, net	4,398	
Total assets	$ 141,783	$ 266,008
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable and accrued expenses	$ 3,168	$ 4,465
Repurchase agreements		133,924
Accrued employee compensation and benefits	459	70
Accrued interest payable		48
Accrued restructuring costs	815	
Other liabilities	1,008	1,114
Total liabilities	5,450	139,621
Commitments and Contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value; 1,000,000 shares authorized; 0 shares issued and outstanding at September 30, 2006 and December 31, 2005		
Common stock, $0.01 par value; 1,000,000,000 shares authorized; 46,534,296 shares issued and outstanding at September 30, 2006 and 44,018,946 shares issued and outstanding at December 31, 2005	466	440
Additional paid-in capital	2,605,277	2,593,085
Accumulated deficit	(2,469,613)	(2,467,138)
Unrealized gain on investments available for sale	555	
Treasury stock	(352)	
Total stockholders equity	136,333	126,387
Total liabilities and stockholders equity	$ 141,783	$ 266,008

See accompanying notes to Condensed Consolidated Financial Statements.

NEXCEN BRANDS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(IN THOUSANDS, EXCEPT SHARE DATA)
(unaudited)

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
Interest income from mortgage-backed securities	$ 921	$ 3,252	$ 4,477	$ 7,158
Interest income from cash and cash equivalents	419	66	775	301
Interest expense on repurchase agreements		(2,132)	(1,354)	(3,851)
Net interest income	1,340	1,186	3,898	3,608
Gain (loss) on sale of mortgage-backed securities		(159)	(490)	264
Other than temporary impairment on mortgage-back securities			(552)	
Other income	415	53	497	260
Advisory and other fees	54		65	
Other operating income (loss)	469	(106)	(480)	524
Operating expenses:				
Selling, general and administrative expenses	(2,281)	(1,036)	(5,146)	(4,146)
Investment advisor fees	(44)	(108)	(134)	(289)
Depreciation and amortization	(207)	(29)	(256)	(107)
Restructuring charge	(80)		(869)	7
Total operating expenses	(2,612)	(1,173)	(6,405)	(4,535)
Operating loss	(803)	(93)	(2,987)	(403)
Non-operating income (expense)				
Other interest income	314	331	856	901
Investment loss				(19)
Total non-operating income	314	331	856	882
Income (loss) from continuing operations	(489)	238	(2,131)	479
Discontinued operations				
Loss on sale of discontinued operations	(333)	(1,073)	(344)	(1,194)
Loss from discontinued operations	(333)	(1,073)	(344)	(1,194)
Net loss	(822)	$ (835)	(2,475)	$ (715)
Other comprehensive income (loss):				
Unrealized holding gains (losses) on investments available for sale	555	(2,728)	555	(3,332)
Comprehensive loss	$ (267)	$ (3,563)	$ (1,920)	$ (4,047)
Net income (loss) per share (basic and diluted) from continuing operations	$ (0.01)	$ 0.01	$ (0.04)	$ 0.01
Loss on sale of discontinued operations	(0.01)	(0.03)	(0.01)	(0.03)
Net loss per share (basic and diluted)	$ (0.02)	$ (0.02)	$ (0.05)	$ (0.02)
Weighted average shares outstanding				
Basic	46,534	44,019	45,098	44,006
Diluted	46,534	44,019	45,098	44,006

See accompanying notes to Condensed Consolidated Financial Statements.

NEXCEN BRANDS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(DOLLARS IN THOUSANDS)
(unaudited)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Unrealized Gain (Loss) On Investments	Total
Balance at December 31, 2004	$	$ 440	$ 2,592,977	$ (2,462,611)	$	$ (216)	$ 130,590
Exercise of options and warrants			32	(7)			25
Option and warrant expense			76				76
Unrealized loss on investments available for sale						(3,332)	(3,332)
Net loss				(715)			(715)
Balance at September 30, 2005	$	$ 440	$ 2,593,085	$ (2,463,333)	$	$ (3,548)	$ 126,644
Balance at December 31, 2005	$	$ 440	$ 2,593,085	$ (2,467,138)	$	$	$ 126,387
Exercise of options and warrants			1				1
Option and warrant expense			1,966				1,966
Common stock issued		26	10,225				10,251
Common stock repurchased					(352)		(352)
Unrealized gain on investments available for sale						555	555
Net loss				(2,475)			(2,475)
Balance at September 30, 2006	$	$ 466	$ 2,605,277	$ (2,469,613)	$ (352)	$ 555	$ 136,333

See accompanying notes to consolidated financial statements.

5

NEXCEN BRANDS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(unaudited)

	Nine Months Ended September 30, 2006	2005
Cash flows from operating activities:		(revised)
Net (loss) income from continuing operations	$ (2,131)	$ 479
Adjustments to reconcile net loss from continuing operations to net cash provided by (used in) operating activities:		
Depreciation and amortization	256	107
Amortization of mortgage premiums		442
Other than temporary impairment loss on mortgage-backed securities	552	
Realized loss on sale of MBS	490	
Share-based compensation expense	1,084	76
Investment gains, including impairments		(245)
Changes in assets and liabilities:		
Decrease (increase) in interest receivable	630	(933)
Decrease in prepaid expenses and other assets	19	3,693
(Decrease) increase in accounts payable, accrued expenses, accrued employee compensation & benefits, and accrued interest payable	(1,448)	27
Increase (decrease) in accrued restructuring costs and other liabilities	763	(259)
Discontinued operations	(344)	(1,194)
Net cash (used in) provided by operating activities	(129)	2,193
Cash flows from investing activities:		
Sales and maturities of investments available for sale	138,978	106,724
Purchases of mortgage-backed securities		(387,349)
Principal payments from mortgage-backed securities	34,199	58,150
Purchase (disposal) of property and equipment, net	(9)	32
Acquisition, net of cash acquired	(3,296)	
Net cash provided by (used in) investing activities	169,872	(222,443)
Cash flows from financing activities:		
Decrease in restricted cash		199
(Repayment of) proceeds from repurchase agreements	(133,924)	181,749
Purchase of treasury stock	(352)	
Exercise of options and warrants	2	25
Net cash (used) provided by financing activities	(134,274)	181,973
Net increase (decrease) in cash and cash equivalents	35,469	(38,277)
Cash and cash equivalents, beginning of period	1,092	60,723
Cash and cash equivalents, end of period	$ 36,561	$ 22,446
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$ 1,403	$ 3,773

Supplemental disclosure of non-cash investing and financing activities:

In June 2006 and in connection with the acquisition of a business, the Company issued 2.5 million shares of common stock, 440,000 warrants and options to acquire 106,236 shares of stock with an aggregate fair value of $11,077,000.

For the nine months ended September 30, 2006 and 2005, the Company recorded unrealized holding gains and (losses) of $555,000 and ($3,332,000), respectively, associated with its investments available for sale. These amounts have been reported through changes in stockholders equity.

See accompanying notes to Condensed Consolidated Financial Statements.

6

NEXCEN BRANDS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) ORGANIZATION, DESCRIPTION OF THE BUSINESS, AND BASIS OF PRESENTATION

(a) ORGANIZATION AND DESCRIPTION OF THE BUSINESS

At the October 31, 2006 annual stockholders meeting, the stockholders of Aether Holdings, Inc. approved a name change of Aether Holdings, Inc. to NexCen Brands, Inc. NexCen Brands, Inc. (the Company or NexCen) is a holding company that owns 100% of the stock of each of Aether Systems, Inc., UCC Capital Corporation, and NexCen Franchising Brands, Inc. Effective November 1, 2006, the Company changed its ticker symbol under which its stock is traded on the NASDAQ Global Market from AETH to NEXC .

Aether Systems was formed in January 1996. On July 12, 2005, the stockholders of Aether Systems approved a holding company reorganization of Aether Systems in which each share of Aether Systems common stock was exchanged for one share of common stock of Aether Holdings and Aether Systems became a wholly owned subsidiary of Aether Holdings. The reorganization was designed to help to protect the long-term value to Aether of its substantial net operating loss and capital loss carryforwards. Aether Systems principal business activity is the investment in mortgage-backed securities (MBS). Aether Systems is the historical entity through which we previously conducted the Mobile Government, EMS and Transportation businesses, which we sold in 2004.

On June 6, 2006 NexCen and its wholly-owned subsidiary AHINV Acquisition Corp. (Merger Sub) entered into an Agreement and Plan of Merger (the Merger Agreement) with UCC Capital Corp., UCC Consulting Corp. and UCC Servicing, LLC (collectively, UCC). The transactions contemplated by the Merger Agreement were completed on June 6, 2006. Each UCC entity was merged with and into Merger Sub, with Merger Sub surviving as a wholly-owned subsidiary of NexCen. Subsequent to the merger, Merger Sub was renamed UCC Capital Corp. Historically, UCC Capital has provided strategic advice and structured finance solutions to intellectual property (IP) centric companies. IP centric companies own, license or otherwise possess rights to trademarks, trade names, copyrights, patents, trade secrets and other intangible assets. While UCC has continued to provide these services to third-parties since the merger, it is the Company s intent to transition to a business model in which the Company acquires and manages IP and IP centric businesses primarily in the retail, consumer branded products and franchising business.

At the 2006 annual stockholders meeting, which was held on October 31, 2006, the Company s stockholders approved the sale of its remaining mortgage backed securities (MBS) portfolio for the purpose of discontinuing its MBS business and allocating all cash proceeds from such sale to the growth and development of the Company s intellectual property (IP) business. One security was sold and settled on October 31, 2006, with the remainder sold pursuant to forward sale arrangements which will settle on November 21, 2006. The Company expects to recognize a gain in the fourth quarter of 2006 of approximately $743,000 relating to the sale of these securities. The Company is no longer engaged in the MBS business.

On November 7, 2006, the Company, through its NexCen Franchising Brands subsidiary, completed the purchase of all of the outstanding equity interests in Athlete s Foot Brands, LLC (Brands) and Athlete s Foot Marketing Support Fund, LLC (AFMSF), along with certain nominal fixed assets owned by an affiliate of Brands (the Acquired Assets and together with Brands and AFMSF, TAF) for initial consideration of $51.5 million, all in accordance with the terms of that certain Equity Interest and Asset Purchase Agreement, dated August 21, 2006, by and among the Company, NexCen Franchise Brands, Inc., NexCen Franchise Management, Inc., Athlete s Foot Marketing Associates, LLC, Brands, and the stockholders named therein (the TAF Agreement). The purchase price consisted of approximately $42.1 million in cash and approximately $9.4 million in common stock of NexCen. The Company intends to finance a portion of the cash amount from a new senior bank facility that it is in the process of negotiating. The 1,413,423 initial shares of Company common stock issued was based on the average closing price of NexCen s common stock over the five trading days prior to the closing. At the closing, the Company also issued 500,000 warrants for the purchase of the Company s common stock to one of the selling stockholders in connection with the transaction. Additionally, the purchase agreement provides for a one-time contingent consideration payment of up to an additional $8.5 million. The contingent consideration payment will be determined based upon Brands December 31, 2006 audited financial statements and will be determined by taking the average of the Revenue Calculation and the EBITDA Calculation as those terms are defined in the purchase agreement, for the four quarters ending December 31, 2006, less the initial consideration. Contingent consideration, if any, will be paid in the same proportion of cash and common stock as the initial consideration. Brands is an athletic footwear and apparel franchisor with 600 retail locations in over 40 countries. AFMSF provides advertising and marketing support for the benefit of Brands franchisees. AFMSF receives a percentage of royalty revenue received by Brands from franchisees and in turn uses those funds for print advertising, public relations, marketing and market research for the benefit of franchisees.

(b) BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements include the accounts of the Company and its subsidiaries. The Condensed Consolidated Balance Sheet as of September 30, 2006 and the Condensed Consolidated Statements of Operations and Other Comprehensive Income (Loss) for the three and nine months ended September 30, 2006 and 2005, and the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2006 and 2005, have been prepared by the Company, without audit. In the opinion of management, all adjustments have been made, which include normal recurring adjustments necessary to present fairly the Condensed Consolidated Financial Statements. Operating results for the three and nine month periods ended September 30, 2006 are not necessarily indicative of the operating results for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. The Company believes that the disclosures provided are adequate to make the information presented not misleading. These Condensed Consolidated Financial Statements should be read in conjunction with the Audited Consolidated Financial Statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

(c) RECLASSIFICATIONS

Certain 2005 amounts have been reclassified to conform to the current year presentation. None of these reclassifications had a material effect on the Company s consolidated financial statements.

(d) REVISED CASH FLOWS

For the nine months ended September 30, 2005, the Company has separately disclosed the operating, investing and financing portions of the cash flows attributed to its discontinued operations, which in prior periods were reported on a combined basis as a single amount.

(e) GOODWILL AND INTANGIBLE ASSETS

The Company accounted for its purchase of UCC in accordance with SFAS No. 141 Business Combinations . Goodwill represents the excess of the acquisition cost over the fair value of the net assets acquired. Goodwill is evaluated for impairment annually, or more frequently, as required in accordance with SFAS No. 142 Goodwill and Other Intangible Assets. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives and are reviewed for impairment in accordance with SFAS No. 144 Accounting for Impairment or Disposal of Long-Lived Assets.

(2) CASH AND CASH EQUIVALENTS

Cash equivalents include all highly liquid investments with maturities of three months or less. Cash and cash equivalents consisted of the following:

(in thousands)	**SEPTEMBER 30, 2006**	**DECEMBER 31, 2005**
Cash	$ 393	$ 832
Money market accounts	1,136	222
U.S. Government Agency-sponsored securities	35,032	38
Total	$ 36,561	$ 1,092

Interest income from cash and cash equivalents is presented in the Condensed Consolidated Statements of Operations and Comprehensive Loss as follows;

Interest income from cash and cash equivalents allocated to our MBS business that were temporarily invested in short-term U.S. Government Agency-sponsored cash equivalents is included in net interest income.

Interest income on all other cash equivalents, as well as interest income on the subordinated secured promissory note and investments with maturities of less than 12 months is included in other interest income.

(3) MORTGAGE-BACKED SECURITIES, AT FAIR VALUE

Prior to the discontinuation of its MBS business, the Company owned hybrid adjustable-rate mortgage-backed securities issued by the Federal National Mortgage Association (FNMA). Hybrid adjustable-rate MBS are characterized by periodic caps on the interest rates on the underlying mortgages (generally, each rate adjustment is limited to 2% after the initial 36 month rate adjustment period and each 12 month rate adjustment period thereafter) as well as lifetime caps.

At the end of 2005 and throughout 2006, management has not had the firm intention to hold the existing MBS investments until maturity or until such time the fair value of these securities would recover. Accordingly, the Company determined that unrealized losses in the MBS portfolio through June 30, 2006 should be considered other than temporary and should be charged against earnings. As a result, $552,000 was charged against earnings for the six months ended June 30, 2006. During the three months ended September 30, 2006, the fair value of these securities increased by $555,000, which was recorded as an unrealized holding gain on investments available for sale. This amount is reported as a component of stockholders equity at September 30, 2006, and will be recognized as a gain in the fourth quarter of 2006 since these securities were sold in October and November 2006.

During the first quarter of 2006, adverse market conditions resulted in a negative interest rate spread for the leveraged portion of the MBS portfolio. Consequently, the Company decided to de-lever its MBS portfolio and on March 8, 2006, entered into a commitment with Jefferies & Company, Inc. (Jefferies) to sell approximately $140 million of MBS. This transaction settled on March 27, 2006. The Company used approximately $119 million of the sale proceeds to repay all of its outstanding short-term borrowings under repurchase agreements. The impairment charge of approximately $4.0 million that was included in loss from continuing operations in the fourth quarter of 2005 included $2.5 million of losses associated with the specific MBS that the Company sold on March 27, 2006. The Company recorded an additional loss on the sale of these MBS of approximately $490,000 in the first quarter of 2006 in connection with this sale.

For the nine months ended September 30, 2005, the Company had recorded adjustments to unrealized holding losses of approximately $3,332,000 associated with its investments available for sale. This amount was reported as a component of other comprehensive loss in stockholders equity as the Company believed that these unrealized losses were temporary in nature.

Mortgaged-backed securities are summarized as follows:

September 30, 2006 (In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
FNMA	$ 79,681	$ 555	$	$ 80,236

Interest income from mortgage-backed securities is as follows:

(in thousands)	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Interest earned on MBS	$ 923	$ 4,486	$ 3,508	$ 7,616