



Form 10-K for AMERICAN RARE EARTHS & MATERIALS, CORP.

24-Sep-2010

Annual Report

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Overview

Since 2002, our Company has been commercializing Rare Earth metals and advanced materials. This led to a vertical integration that began with the extraction of pure Scandium and other Rare Earths applications in the form of extruded, rolled or forged products and components. Today, that expertise has positioned us to become a leader in commercializing Rare Earth metals and advanced materials and quickly delivering revolutionary new products to consumer and industrial markets. Our objective is to become North America's best, most reliable source for Rare Earth metals and provide solutions to their applications. We are developing opportunities to distribute Rare Earths like Scandium, Neodymium, Europium and Lithium that will help major industries launch major industrial brands such as hybrid cars, flat screen televisions, LED light bulbs and wind turbines. We will also have significant exposure to large market categories such as transportation, shipbuilding, power transmission, automotive and aerospace.

The first products manufactured using the Company's proprietary golf technology have been produced and the Company commenced distribution to wholesalers and retail markets during the last quarter of its fiscal year ended June 30, 2006. In June, 2007 the Company expanded its sales into recreational fishing equipment.

In January 2010, the Company entered into a Trademark License, Product Distribution Agreement and Management Agreement with Zeroloft Corp. Within the field of sportswear apparel, footwear and related sports specialty items, the Company obtained: (i) an exclusive license to the Zeroloft Aspen Aerogels trademarks; and (ii) a limited, worldwide, exclusive right to distribute the products bearing the Zeroloft Aspen Aerogels Trademark for production and sales of items in such field. The License Agreement has a term of five years, which term is automatically renewable for one year terms. We are currently working with major footwear and apparel manufacturers to incorporate Zeroloft into their lines of products. Russell Athletics, Hanesbrands and Camelbak have tested and incorporated Zeroloft into their product lines which we anticipate will be available to consumers in 2010 and 2011.

Our business, financial condition, cash flows and results from operations are subject to seasonality resulting from factors such as weather and spending patterns. Due to seasonality of our business, one quarter's results are not indicative of the full fiscal year's expected financial results. A majority of our revenue is earned in the third and fourth quarters of the year and revenues generally decline in the first and second quarters. During the current fiscal year, a greater portion of our annual fishing sales took place in the second quarter when compared to the prior year because we moved our production schedule forward and shipping to our customers earlier.

Results of Operations

Years Ended June 30, 2010 and 2009

For the year ended June 30, 2010, the Company had revenue of \$4,341,362 which includes non-cash barter revenue of \$58,802 and reimbursement of out-of-pocket costs incurred on behalf Zeroloft Corp. of \$554,143, and incurred costs of sales of \$2,606,199 and general and administrative expenses of \$6,086,881 and interest income of \$1,725, and interest expense of \$127,571. Included in general and administrative expense is a non-cash charge of \$3,031,736 representing the value of compensatory common stock and warrants for services provided by consultants. This resulted in a net loss of \$4,477,564, as compared with the year ended June 30, 2009 in which the Company had revenue of \$4,008,633, which includes non-cash barter revenue of \$212,919, incurred costs of sales of \$2,307,868 and general and administrative expenses of \$3,136,906, and interest income of \$3,033, and interest expense of \$255,302, offset by derivative income of \$95,250, resulting in a net loss of \$1,593,160. Included in general and administrative expense for fiscal 2009 is a non-cash charge of \$1,075,605 representing the value of compensatory common stock and warrants for services provided by consultants. In fiscal 2010, we launched the Micro Guided series of fishing rods.

The Company has expanded its number of stock-keeping units or SKUs in the fishing rods segment to over 100 SKUs with new lines. Compensatory expenses, which are included in general and administrative expenses, have increased from prior periods as we have incurred additional consultant and professional fees related to the rollout of Zeroloft, management consulting, business advisory, shareholder information and public relations.

Interest expense of \$127,571 and \$255,302 for the years ended June 30, 2010 and 2009, respectively, primarily relates to paid and accreted interest on the Convertible Debenture and Loan payable to shareholder.

Our net accounts receivable balances were \$789,920 and \$515,577 at June 30, 2010 and 2009, respectively. The increase in accounts receivable compared to June 30, 2009 is primarily due to a June 2010 promotion for fishing rods. The Company is subject to risk of non-payment of its trade accounts receivable. For the year ended June 30, 2010, two customers (which was as of 2009, two customers) respectively represent approximately 23% and 10% of sales (which was as of 2009, 27% and 14%) and 29% and 13% (which was as of 2009, 30% and 16%) of the total outstanding accounts receivable. Management continually monitors its credit terms with customers to reduce credit risk exposure.

Our accrued receivable balances were \$554,143 and \$0 at June 30, 2010 and 2009, respectively. The accrued receivable resulted from an agreement with Zeroloft Corp. to reimburse \$554,143 of out-of-pocket costs incurred by us as at June 30, 2010. It was agreed that total expenditures of \$111,231 paid in cash by AREM at June 30, 2010 will be reimbursed in cash by Zeroloft Corp. and total expenditures paid in stock-based compensation of \$442,912 by AREM at June 30, 2010 will be applied to reduce the liability 'Due to Zeroloft Corp.' On September 2, 2010, AREM received cash of \$500,000 from Zeroloft Corp. From this cash receipt, \$111,231 was applied to accrued receivables recorded at June 30, 2010 and the remaining balance of \$388,769 is available to be applied against out-of-pocket costs incurred in future periods.

Our net inventory balances were \$919,158 and \$1,276,891 at June 30, 2010 and, 2009. The decrease in our inventory balance is due to an increase in our provision for inventory obsolescence from \$178,000 to \$542,195 during this year. The provision only relates to golf equipment and components other than golf shafts. Our inventory comprises golf and fishing products and components. We concentrate our new purchases of inventory on where we anticipate our future sales; golf shafts and our best selling SKUs. During the year we were successful in placing our fishing rods in Dick's Sporting Goods.

Our royalty payable and accrued expenses were in total \$3,514,585 and \$2,621,996 at June 30, 2010 and 2009, respectively. The increase in the balances is primarily due to unpaid royalties to Advanced and unpaid compensation to senior management. The royalty is calculated as 20% of the net selling price of fishing products sold by the Company and any sub licensee.

Liquidity and Capital Resources

The Company has negative working capital as of June 30, 2010 of \$124,889. The Company retains consultants to perform development and public company reporting activities in exchange for stock of the Company. At June 30, 2009, we had a working capital deficiency of \$1,125,566. Our working capital deficiency is due to unpaid royalties. Our continuation as a going concern will require that we raise significant additional capital. Included in accrued expenses is \$1,795,746 owed by the Company to

the President (which was at June 30, 2009, \$1,640,039). There is no assurance that consultants will continue to accept stock compensation for services. If consultants discontinue accepting stock compensation we may not be able to continue to retain the services of such consultants.

During the year ended June 30, 2010, the Company purchased a vehicle for \$35,569, purchased a redeemable guaranteed investment certificate for \$250,000 earning interest at 0.75% per annum and repaid short-term debt of \$325,000.

On August 3, 2009, 50,000 warrants were exercised at \$0.10 per share of common stock resulting in the Company receiving \$5,000. On January 11, 2010, 75,000 warrants were exercised at \$0.10 per share of common stock resulting in the Company receiving \$7,500. On January 15, 2010, 150,000 warrants were exercised at \$0.10 per share of common stock, resulting in the Company receiving \$15,000. On January 19, 2010, 857,142 warrants were exercised at \$0.35 per share of common stock, resulting in the Company receiving approximately \$300,000.

Absent continued stock payment for services to our consultants and continued advances by stockholders of the Company, the Company cannot manufacture its golf shaft or fishing product lines or market its products based on its technologies or continue as a going concern.

In consideration for the License Agreement, the Company issued to Zeroloft 4,444,444 of shares of common stock of the Company valued at \$2,888,888 on January 14, 2010 and, at the sole discretion of Zeroloft, it will either: (i) issue an additional \$1 million worth of Shares, at the then market price; or make installment payments of \$200,000 per year for five years. Pursuant to the License Agreement, the Company shall have the right to sublicense and shall pay to Zeroloft a royalty of 50% of the net license revenue resulting from the manufacture, distribution or sale of products by sublicensees. Since payments of royalties only arrive upon the occurrence of sales, the Company expects that royalty payments will not have a negative effect on its revenues and it will have sufficient liquidity to meet its obligation.

On January 14, 2010, the Company entered into a Management Agreement with Zeroloft ("Management Agreement") pursuant to which the Company will render services for the operation and expansion of Zeroloft's manufacturing and licensing of its proprietary, Zeroloft Aspen Aerogels[®] branded weather-resistant fabric, product made of such fabric, thermal insulation and related insulating fabrics in the field of use. In consideration for providing such services, the Company will receive a management fee of approximately: (i) five percent (5%) on gross receipts of sales of items made of Zeroloft product with a value of less than two (2) US dollars per square foot, less royalties; and (ii) ten percent 10% on gross receipts of sales of items made of Zeroloft product with a value greater than two (2) US dollars per square foot from sales made through the efforts of the Company. For the year ended June 30, 2010, the Company

has generated revenue of \$143,534 from royalties, management fees, product and services related to Zeroloft product and \$554,143 of revenue for recovery of out of pocket costs from Zeroloft Corp. The terms of our contract with our Zeroloft customers require a prepayment which will cover our expected upfront costs.

Although the Company has previously been able to raise capital as needed, such capital may not continue to be available at all, or if available, that the terms of such financing will not be dilutive to existing stockholders or otherwise on terms not favorable to the Company or existing stockholders. Further, the current global financial situation may offer additional challenges to raising the required capital. If the Company is unable to secure additional capital, as circumstances require, it may not be able to continue operations.

If adequate funds are not available or not available on acceptable terms, we may be unable to continue operations; develop, enhance and market products, retain qualified personnel; take advantage of future operations; or respond to competitive pressures, any of which could have a material adverse effect on our business; operating results; financial condition and/or liquidity.

With the introduction of new materials in fishing and apparel markets, Element 21 changed its name from Element 21 Golf Company to American Rare Earths and Materials, Corp. on July 12, 2010 expanding our market designation from golf, fishing and recreation products to materials and their applications. In addition, Element 21 re-domesticated from the State of Delaware to the State of Nevada. The Element 21 brand name, Carrot Stix, and all related consumer brands will remain as is. The Company has a new corporate master brand and it will expand its portfolio of products to provide metals and materials.

Recent Accounting Pronouncements

See Note 1 (r) "Recent Accounting Pronouncements" in the Notes to Consolidated Financial Statements for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition, which is incorporated herein.

Critical Accounting Policies

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. The Company bases its estimates on historical experience and on various

other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

Stock-Based Compensation

The Company follows FASB ASC Subtopic 718, Stock Compensation, for accounting for stock-based compensation. Compensation cost is calculated on the date of the grant using the Black Scholes-Merton option-pricing formula. The compensation expense is then amortized over the vesting period. The Company uses the Black-Scholes-Merton option-pricing formula in determining the fair value of the Company's options at the grant date and applies judgment in estimating the key assumptions that are critical to the model such as the expected term, volatility and forfeiture rate of an option. The Company's estimate of these key assumptions is based on historical information and judgment regarding market factors and trends.

For non-employee stock-based compensation, the Company follows ASC Topic 505 - Equity-Based Payments to Non-Employees, which requires stock-based compensation related to non-employees to be accounted for based on the fair value of the related stock or options or the fair value of the services on the grant date, whichever is more readily determinable in accordance with ASC Topic 718.

Allowance for Doubtful Accounts

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required, which would be charged against earnings.

Product Warranty

The Company reserves for the estimated cost of product warranties at the time revenue is recognized based on historical claim experience and any additional future costs on previously sold products. Our liability incorporates the cost of product replacement, packaging and freight charges. Our current warranty relates entirely to fishing rods on which we generally provide a lifetime warranty. Considerable judgment is used to determine the estimate. If actual costs differ significantly from our estimates, the Company would record the impact of these unforeseen costs in subsequent periods.

Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating the actual current tax liabilities together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. The most significant tax assets are available net operating loss carryforwards. We must then assess the likelihood that the deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, a valuation allowance must be established. To the extent we establish a valuation allowance or increase or decrease this allowance in a period, the impact will be included in the tax provision in the statement of operations. Significant management judgment is required to determine our provision for income taxes and the recoverability of the deferred tax asset. It is based on our estimates of future taxable income by jurisdiction in which we operate and the period over which the deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, a valuation allowance may need to be established which could result in a tax provision equal to the carrying value of the deferred tax assets.

Inventories

Inventory consists primarily of goods held for resale and their components. Inventory is stated at the lower of cost or market with cost determined using the weighted-average method. In evaluating whether inventory is stated at the lower of cost or market, management considers such factors as the amount of inventory on hand and in the distribution channel, estimated time required to sell such inventory, remaining shelf life and current and expected market conditions, including levels of competition. As appropriate, a provision is recorded to reduce inventory to its net realizable value.

Intangible Asset Subject to Amortization

The Company evaluates its long-lived assets for indicators of possible impairment. Intangible assets subject to amortization held and used by the Company is reviewed for impairment whenever events or changes in circumstances indicate that its net book value may not be recoverable. When such factors and circumstances exist, the Company compares the projected undiscounted future cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets and is recorded in the period in which the determination was made.

About Us

American Rare Earths and Materials (OTCBB:AREM - News) is a leader in commercializing Rare Earth metals and quickly delivering revolutionary new products to consumer and industrial markets. The company is focused on low-risk, high-return, high-demand industries that use Rare Earth metals including aerospace, alternative energy, automotive, power transmission, shipbuilding, and transportation as well as selected consumer markets (sporting goods equipment). The company also develops advanced chemicals and materials. American Rare Earths and Materials is committed to becoming American's best and most reliable source for Rare Earth metals and advanced chemicals and materials and to fully leverage the global mega-trends in these categories. For more information, visit www.americanrare.com.